

**HOUSING SECTOR REFORM
PROJECT II**

FINAL REPORT

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Housing Sector Reform Project II
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TABLE OF CONTENTS

EXECUTIVE SUMMARY	4
OVERVIEW	6
1. INTRODUCTION	7
2. SUMMARY OF ACCOMPLISHMENTS	10
PRINCIPAL ACTIVITIES	22
3. DEVELOPMENT OF NATIONAL LEGISLATION	23
4. HOUSING DIVESTITURE AND WORK WITH REGIONAL CITIES	32
5. HOUSING FINANCE	55
6. AGENCY FOR RESIDENTIAL MORTGAGE LENDING	85
7. INFRASTRUCTURE FINANCE: LONG-TERM DEBT FINANCING OF CAPITAL INVESTMENT FOR INFRASTRUCTURE	MUNICIPAL 93
8. SMALL GRANTS PROGRAM	106
THE FUTURE	115
9. INSTITUTIONALIZATION	116
10. WHAT REMAINS TO BE DONE	121

ANNEXES

- A HSRP PRESENTATIONS AND SEMINARS
- B LIST OF PROJECT REPORTS
- C LIST OF STUDY TOURS

EXECUTIVE SUMMARY

Few donor programs can claim to have succeeded in fundamentally reforming a major economic sector in a large country. USAID, through the Housing Sector Reform Project, has built the sturdy foundation and partially completed the superstructure for housing sector reform in the Russian Federation.

The Housing Sector Reform Program, executed over the six year period from September 1992 through September 1998, can be credited with driving the reform of a major sector of the Russian economy: the housing sector. This is no mean accomplishment, given that the famous Shatalin "500 days" report, prepared on the eve of the transition rated the housing sector as the least efficient sector in the Soviet Union. By the conclusion of the contract the majority of housing units were privately owned; most enterprises have divested their housing to municipalities and now have greater concentration for their principal work; household mobility rates had soared, and the majority of families are finding their housing through market means rather than waiting on the municipal waiting list; broad rent controls had been replaced with a program that is gradually raising rents to full cost recovery levels and targetting the remaining subsidies on low income people; and most construction is organized by private developers and carried out by private contractors.

The present report is about HSRP II, the second phase of the overall effort. HSRP I and II overlapped for most of two years and during the second year of this period were operated as a single project. Like its predecessor, it continued to focus on reform in the housing sector *per se*. But there were significant shifts in emphasis and some additions. Most importantly, reform of municipally provided communal services--particularly water and wastewater services and district heat systems--were awarded much greater prominence, attention consistent with their large share of total housing expenses of tenants. Attention of was given to working with banks to initiate lending for construction period finance for the first time. And a small grants program for local NGOs was added to encourage the development of citizens and local groups in pressing for further housing reforms, including formation of condominium associations.

HSRP II also embodied a philosophy of concentrating the program's effort on target cities, whose success could then be used as a model for other cities. This strategy proved less compelling in practice than expected and after the first year a more flexible approach was pursued. The change put great stress on project services being demanded by client cities and banks. This approach worked extremely well, although progress in some clients was on something of a start-and-go basis.

HSRP II's principal accomplishments can be summarized as follows:

- dramatically extending the range of municipalities assisted with reforms through the operation of four "Regional Centers" covering the four corners of Russia in the second program year and through working with fourteen widely scattered pilot cities selected by Minstroi in the third year; the project's aggressive seminar and presentation program reached more than 14,000 attendees at events in 54 cities;
- pioneering practical work with municipal communal service providers and their regulators on an improved regulatory system and tariff setting practices;
- creating the first practical vehicles for middle term finance of municipal infrastructure using bank loans and bond financing; this work also assisted in the creation of Russia's first credit rating agency at the Institute for Urban Economics;

- providing critical assistance to the Ministries of Construction, Finance, and Economy in the development of a large number of new laws, Government Resolutions, and Presidential Decrees; and
- being a very strong partner to the Russian government in the creation of the Agency for Mortgage Lending--a secondary mortgage facility--whose operations should sharply extend the volume of mortgage lending by private commercial banks by addressing their liquidity concerns.

The project succeeded in fulfilling the great majority of the ambitious goals set for it by USAID. Overall, 85 percent of the 130 goals specified in the successive workplans were achieved. (In this accounting, if a goal involved succeeding in a number of cities or banks, each city or bank was treated as a separate goal; so, the project may have succeeded in having five of six client cities raise rents to a certain standard level.) Where goals were not achieved, it was nearly universally due to local or national governments not taking some necessary action.

Perhaps the project's most significant result was fostering the creation and development of the Institute for Urban Economics, a non profit think tank founded by the senior Russian consultants of the Urban Institute in November 1995. In its short life IUE has become the recognized leader in Russia on housing and communal reform issues. HSRP helped IUE put strong project management and financial management systems in place and to diversify its activities and client base. The most notable of its diversification results was the creation of Russia's first credit rating agency within IUE. A sign of the quality of its work is that the agency signed a strategic alliance agreement with Standard and Poor's in August 1998. IUE has built a firm foundation and is ready to continue to advance reform in the sector.

Compared with the situation in 1991 and the inherited Soviet system for housing and communal services, extraordinary progress has been made. Nevertheless, a great deal remains to be done. The devolution of responsibility for many housing policy decisions to local governments (when ownership of the State housing stock was transferred to them) means that the national government's role is limited substantially to passing enabling laws and providing leadership. The reform movement consistently has consistently obtained the necessary national level support. But the battle for reform will ultimately be won or lost at the local level. Reaching out to local governments and regional banks is a process that must be continued. Demonstration projects and advice will remain the principal tools in the years ahead to promote

- reform in communal services regulation, management, finance and tariff setting,
- further increases in rents in municipal housing and redefinition to add capital costs and differentiate rents by quality and location of individual units, and correspondingly strengthen the housing allowance programs,
- and expansion of the use of competitions to select firms to maintain and management housing,
- a much higher incidence of condominium creation and of local housing NGOs, and
- an expansion in the incidence and volume of mortgage and commercial real estate lending among regional banks.

PART I
OVERVIEW

1. Introduction

The Basic Charge

The Housing Sector Reform Project II (HSRP II) was a three year project which became effective at the end of September 1995. It was designed to build on the strong progress made in reforming Russia's housing sector, with USAID-assistance under the predecessor contract, HSRP I, which had a five year activity span from September 1992 through August 1997.¹ Because of the broad progress made by the time HSRP II was designed, it was possible for USAID to select a targeted approach to the incremental assistance. This is supported by the summary statement in the contract:

The HSRP II is planned as a 3 year activity...to assist Russian municipalities and enterprises in privatizing housing assets and developing construction and infrastructure financing methods, thereby assisting the government of the Russian Federation in achieving its goal of privatizing new housing construction and developing a prosperous, market-based housing sector.

More specifically, the contract enumerated five areas in which work was to be concentrated:

- housing finance -- including both mortgage finance and funding for rehabilitation of buildings owned by condominium associations
- construction period finance
- infrastructure for municipalities -- including both financing improvements and extensions and increasing efficiency of the operations of municipal utilities
- enterprise housing divestiture
- housing and urban land market reform.

The contract also stated that project activity should include a small grants program to support grass-roots NGOs working in the housing sector.

Further the contract enunciated the strategy that work in these areas during the first contract year should be concentrated in four municipalities and *oblasts* so that the impact of the technical assistance would be maximized and these localities could serve as models for other cities and regions. The target localities in the first year were the municipalities of Moscow and Ryazan and the *Oblasts* of Vladimir and Nizhni Novgorod.

Moreover, the contract stated that USAID expected three levels of results from the work undertaken:

- direct results in each substantive area
- basis for replication: successful models and procedures in each area for further application within the original and new oblast and municipalities
- human resources: training Russian personnel and institutions capable of continuing without

¹ Work under this project is described in R. Struyk, "Housing Sector Reform Project I: Final Report." Washington, DC: The Urban Institute, 1997.

expatriate assistance.

The first two year of HSRP II overlapped with the last two of HSRP I. Since the Urban Institute was the contractor on both projects fully integration of work under both projects was accomplished. Indeed, after the first year of HSRP II, USAID determined it would more effective for the two projects to be administered together and a combined workplan was developed for 1996-1997. For this year many of the performance indicators for the two projects are joint.

Shifts in USAID Priorities

Over the three year life of HSRP II, USAID has used the resources of the contract to respond flexibly to changes in the Russian housing market, the directions of reform pursued by national and local governments, and the initiatives of other donors. The result was some shift in activities from year to year and the strategy for delivering the technical assistance. A graphic display of the location of the main activities is shown in Figure 1.1. A summary of the project's work year-by-year is given in Figure 1.2.

A good example of changes in program direction concerns mortgage finance. The initial charge was to work with banks in the four target locations to initiate mortgage and construction period finance. While this was accomplished, it was also clear that banks in many locations were interested in initiating such lending, if they could obtain badly needed assistance. So the program was shifted to be demand-driven by banks and not tied to specific locations, although the housing finance team always pursued leads in priority cities. By the fall of 1997, the necessity for special work with banks in either area had declined, since the project had succeeded helping more than 30 banks in all parts of the country begin such lending. In this circumstance, work in the mortgage sector continued by providing assistance to Russia's nascent secondary market institution, the Agency for Housing Mortgage Lending. When the HSRP II contract was signed, the Agency, of course, had not yet existed.

There were also broad changes in the work with regional and municipal governments on housing sector reform. (See Table 1.1.) After the first year the wisdom of concentrating on working with housing divested by enterprises in a few locations seemed questionable because of the low response of tenants to the possibility of forming condominium associations. In this case the shift was to broad the geographic scope of the team's activity by creating Regional Centers in four points distant from Moscow. Also during this year USAID decided that HSRP could support the World Bank's Enterprise Housing Divestiture Project operating in six cities. The Regional Centers concept worked extremely well, but in the third contract year a combination of lower funding and the Government of Russia's priority for the team to work with fourteen "pilot reform cities" prevailed.

Table 1.1
Enterprise Housing Divestiture and
Assistance with Local Housing Reform--Shifting
Emphasis within HSRP II

<i>year</i>	<i>direction</i>
1995-1996	Divestiture is the focus; activity concentrated in municipalities of Moscow and Ryazan, and regions of Vladimir and Nizhni Novgorod
1996-1997	Promotion of housing reform by local governments is priority. Regional Centers established in Vladivostok (Far East), Irkusk (Siberia), Rostov-on-Don (South), and St. Petersburg (Far North). Assistance initiated to six cities included in the World Bank's Enterprise Housing

<i>year</i>	<i>direction</i>
	Divestiture Project.
1997-1998	Promotion of housing reform by local governments is priority. Priority given to 14 "pilot reform cities" selected by the Government of Russia. Assistance continued to six cities included in the World Bank's Enterprise Housing Divestiture Project.

One implications of these shifts is that the performance indicators specified in the contract were replaced with different indicators stated in the project's annual workplans which have been approved by USAID.

The balance of this report details the work carried out under HSRP II.² Chapter 2, the final chapter in Part I, provides an overview of project accomplishments by reviewing the performance indicators, and other measures of project activity and success. Part II then gives in-depth discussion of five selected project activities, ranging from assistance to the Agency for Housing Mortgage Lending to project work in promoting housing reform in the regions. Each chapter describes the assistance provided and the results effected.

Part III then addresses two final topics: the project's accomplishments in institutionalization and what remains to be done in terms of sector reform. A set of annexes complete the record by giving comprehensive lists of reports produced by the project, seminars sponsored and participated in, names of study visit participants, and press coverage of the project.

Overall, the Housing Sector Reform Project has had an enormous impact on one of the least efficient sectors of the Russian economy. The full record of change is extensively and is comprehensively described elsewhere.³ Suffice for now to say that the sector has moved broadly to a market base with some very important improvements in efficiency achieved. At the same time, possible efficiency gains likely equivalent to 1 or 2 percent of GDP remain to be harvested. The opportunities are particularly acute in the communal services sector where both increased finance for investment and improved municipal regulation and tariff setting would result in very large increases in efficiency--and consumer satisfaction. Continued improvement in residential property maintenance and management is another primary target.

² The description covers only the HSRP II "core contract." At the same time this contract was signed a companion "requirements" contract was also signed. Under it four task orders were eventually issued for work on: zoning, commercial real estate lending, stimulating economic development in the *Oblast* of Novgorod through real estate reform, and disseminating the results of a series of USAID-supported pilot projects in real estate reform to Russian professionals.

³ R. Struyk (ed.) *Restructuring Russia's Housing Sector, 1991-1997*. Washington, DC: The Urban Institute.

2. Summary of Accomplishments

The principal work of HSRP was working with local counterparts in drafting legislation at the national or local level and working with local officials and bankers to implement actual reforms, initially on a demonstration basis and later on a more mass scale. This chapter reviews the record from a series of different perspectives: the USAID-defined performance indicators, the number of seminars and courses held, the number of papers produced and disseminated, and number of Russians who visited the U.S. under program auspices to learn new ways of operating.

Performance Indicators

USAID contracts routinely include concrete indicators of a project's expected accomplishments. And HSRP II is no exception. However, even in the first year those specified in the contract were modified in the workplan in light of changes in Russian policies and developments in housing reform, particularly the extent of the divestiture of housing assets by enterprises, that had occurred between when the RFP was written and the contract came into effect. Each of the three workplans prepared during the project included a set of indicators for the performance period covered by the plan. Table 2.1 provides a comprehensive listing of the indicators and statements on the extent to which each was accomplished. The table is organized by topic. So the first part of the table shows the performance indicators for "Enterprise Divestiture and Work in the Regions" for all years. Recall that the indicators for 1996-1997 are for the combined HSRP I & II program. If indicators were defined separately for each year, then three sets of indicators appear under the heading.

Table 2.2 provides an overall summary of the project's record. Note that in this accounting, where a goal or indicator was defined for multiple cities, this was defined as multiple goals. For example, if the project was to encourage rent reform (increases) in five cities during a year and three cities actually reached the goal, then in the accounting in Table 2.2 this is recorded meeting three of five indicators. Overall, the project's record is very strong. It met 111 of the 130 goals defined (85 percent). Where goals were not met, it was generally because a city administration or Federal Agency could not be induced to undertake a reform. Some examples will illustrate this point:

- o In the area of supporting enterprise divestiture and supporting housing reform in the regions, in 1997-1998, the goals called for inducing the 18 pilot cities to keep to the fairly aggressive federal standards for rent increases. Obviously, rent increases are a highly political matter, and it might be considered surprising that the goal was achieved in as many as 13 of the 18 cities.
- o The Agency for Mortgage Lending did not purchase its first mortgage until September 1998, several months later than the date set in the goal for it. The delay was caused primarily by extended negotiations with the Ministry of Finance and Apparatus of Government about the government's contribution to the Agency's equity. Most important, however, is that the Agency did commence operations.

The project was particularly proficient in the areas of institutionalization and administering the small grants program. Its record is also very strong in working with Russian officials to enact the necessary legislation underpinning reforms.

Table 2.1
USAID/Urban Institute-Russian Federation
Housing Sector Reform Project II

Indicators of Program Impact/Success

*Area: Enterprise Divestiture &
Supporting Housing Reform in the Regions*

<i>goals</i>	<i>results</i>
<u>1995-1996</u> 1. promotional materials for unit privatization in former enterprise housing will have been developed and implemented; 2. establish a minimum of five condominium associations in former enterprise housing in each target location; 3. competitively let contracts will have been issued for maintenance and management services; 4. training and support to private maintenance and management firms and condominium associations as stimulated by the divested housing units is being provided by qualified local institutions.	accomplished accomplished in 2 of 4 cities: Nizhni Novgorod (10 of 45 total), Ryazan (6 of 38), Vladimir (0 of 11), Moscow (2 of 36) accomplished accomplished in 2 cities; was accomplished in other 2 by 12/96
<u>1996-1997</u> <i>1. Saint Petersburg</i> -- Condominiums registered: 20 or more -- Maintenance competitions held: 2 -- Condominium training: 1 ⁴ Board of directors:2 Management: 2 <i>Nizhny Novgorod, Vladimir, Ryazan</i> -- Condominiums registered: 10 or more in each city. -- Maintenance competitions held: 2 or more in each city -- Condominium training: Board of directors:2 Management: 2	Goal met. 1 held; goal not met/ only one training for managers held; goal not met Goal met. Goal met. Goal met.

⁴ Second training was done within the next two months.

<p><i>3. Regional Centers</i> (4 Centers; goals for each)</p> <ul style="list-style-type: none"> -- Condominiums registered: 5 or more in each of three cities in the region covered by the Center. -- Maintenance competitions held: 1 or more in each of three cities covered by the Center (Irkutsk excluded)/ -- Condominium Training: Board of directors:2 Management: 2 	<p>Goal met in all regions.</p> <p>Goal met in 2 of 3 regions.</p> <p>Goal met where more than 25 condominiums were registered.</p>
<p><u>1997-1998</u> -- 14 pilot & EHDP cities</p> <p>A. <i>All Cities</i></p> <p>1. Rent reforms: implement the payment scheme in Government Resolution N.707 and approximately keep pace with GOR standards on rent increases</p> <p>B. <i>Advanced Cities:</i> Nizhni Novgorod, Novgorod, Yaroslavl, Petrozavodsk, Cherepovets, Samara, Novocherkassk, St. Petersburg, Vladimir, Ryazan, Volhov, Orenburg⁵</p> <p>1. a minimum 30% increase in the number of condominiums to achieve critical momentum in the formation of such associations to improve housing management and strengthen democratic grass root organizations</p> <p>2. expand competitive maintenance to cover an additional 5% of the municipal housing stock</p> <p>C. <i>Second-tier cities:</i> Tobolsk, Kazan, Ulyanovsk, Nalchick, Magadan, Kansk</p> <p>1. create necessary local normative base and create 2 new condominiums</p> <p>2. create "customer service" and hold at least one competition to select maintenance firm</p> <p>3. preparation of a normative document to guide the city's housing reform program.</p>	<p>Goal met by 13 of 18 cities.</p> <p>Goal met by 10 of 12 cities.</p> <p>Goal met by 6 of 12 cities.</p> <p>Goal met for 5 of 6 cities.</p> <p>Goal met for 4 of 6 cities.</p> <p>Goal met for 5 of 6 cities.</p>

⁵ Some cities are not in the "advanced" category in all aspects of housing reform. For the specific areas where reform has lagged in the city progress will be measured against the standard cited for "second tier" cities.

<p>For the Moscow management initiative:</p> <p>Successful operation of the contractor during the year and acceptance by the City</p>	<p>Goal accomplished: competitively selected contractor took over 30,000 units July 1, 1998; model being replicated.</p>
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Area: Mortgage and Construction Period Finance

<i>goals</i>	<i>results</i>
<p><u>1995-1996</u></p> <p><i>Assistance to banks</i></p> <p>1. a standardized set of documents for construction lending procedures and appropriate construction lending instruments should be available for dissemination;</p> <p>2. procedures are in place and staff trained at 5 banks to initiated construction loans and at 10 banks to initiate mortgage loans;</p> <p>3. at least one institution offering a course in construction lending training.</p> <p><i>Assistance to developers</i></p> <p>4. One institution or professional association offering a course on construction finance lending;</p> <p>5. A "How to" manual for construction finance loan applications developed for use by developers;</p> <p>6. Six projects prepared and loan applications submitted to interested banks.</p>	<p>accomplished</p> <p>accomplished</p> <p>accomplished: Institute for Urban Economics</p> <p>accomplished: Russian Guild of Realtors</p> <p>accomplished</p> <p>accomplished: 9 submitted</p>
<p><u>1996-1997</u></p> <p>Mortgage finance</p> <p>1. 1 or 2 banks initiating mortgage lending added in each regional center not previously served by the project</p> <p>2. IUE develops enhanced housing finance training programs</p> <p>3. A full cycle of courses offered in the Certified Mortgage Lending Program</p> <p>4. Two banks making pilot building</p>	<p>accomplished</p> <p>accomplished</p> <p>accomplished</p> <p>not accomplished⁶</p>

⁶ Such lending was successfully initiated in a USAID supported project conducted by the Cooperative Housing Foundation in Tver. The project had the distinct advantage of having inexpensive funds to offer to banks making such loans. At one

rehabilitation loans to condo associations	
Construction period finance	
1. Five banks making loans; banks will be from both Moscow and the regions	accomplished
2. Dissemination of information through Russian Society of Appraisers & other appraisal and bank organizations	accomplished
<u>1997-1998</u>	
Creation of the <i>Agency for Mortgage Lending</i> : The Agency will purchase its first loans by the spring 1998 and issue its first securities by the summer of 1998.	Not accomplished; first loan purchased in September, and the securities issue is expected in November/

Area: Infrastructure Finance and Regulation

<i>goals</i>	<i>results</i>
<u>1995-1996</u>	
<i>Assistance to municipalities</i>	
1. pilot projects regarding local activities to be subject to long-term financing and tariff reform specified and analyzed in each of six municipalities;	accomplished
2. long-term financing mechanisms for pilot projects identified and agreed to by two municipalities;	agreements with three cities: Nizhni Novgorod, Pskov, and Sudogda Raion (Vladimirskaya Oblast)
3. tariff reform packages discussed in at least two municipalities.	discussed with 5 cities but cities expressed little interest
<i>Assistance to developers</i>	
4. one institution offering a course or segment on alternative approaches to private sector	segment of course; Guild of Realtors

point it appeared that CHF would be able to use its funds for loans in one of the HSRP cities, but this turned out not to be possible.

<p>participation in infrastructure finance;</p> <p>5. Case studies and training materials and a section of a "how to" manual covering public-private partnerships.</p>	<p>accomplished</p>
<p><u>1996-1997</u></p> <p>1. municipal projects analyzed in 2-3 cities</p> <p>2. publications disseminated on: legal aspects of taxation of municipal bonds; guidelines on long-term infrastructure finance; and, "how to" manual on long-term finance infrastructure projects</p>	<p>accomplished</p> <p>accomplished</p>
<p><u>1997-1998</u></p> <p>1. At least 4 cities will have developed financially feasible infrastructure projects, with private sector participation and identified market mechanisms to finance such projects.</p> <p>2. New procedures for analyzing and deciding upon tariff requests from municipal water and heat utilities implemented in at least two cities.</p>	<p>Nizhny Novgorod (Ozonation station) Volgograd (Heating station) Dzerzhinsky (Water purification)</p> <p>Gus-Khrustalny Uglich Nadym</p>

Area: Housing and Land Policy

<i>goals</i>	<i>results</i>
<p><u>1995-1996</u></p> <p>1. development of specific legal and regulatory documents in support of market-oriented privatization of shelter development process;</p> <p>2. creation and dissemination of model documents or regulations for adoption by other local authorities throughout Russia.</p>	<p>accomplished: numerous national and local level laws and regulations enacted</p> <p>accomplished: model land lease agreement; mortgage documentation; condominium charter, acts dealing with condominium registration, transfer of buildings to balance of building, continuation of subsidies.</p>
<p><u>1996-1997</u></p> <p>1. Passage of the Urban Planning Codex by the summer of 1997</p> <p>2. Establishment of the Agency for Mortgage Lending by January 1997</p>	<p>accomplished</p> <p>accomplished: legal basis created in August 1996; Agency registered as an open joint stock company in September 1997</p>

<u>1997-1998 (life of project)</u> Policy, laws and regulations regarding land tenure, property transfer, urban planning and zoning, infrastructure development and shelter will have been formulated, debated and/or adopted at the national or local level as may be appropriate.	accomplished
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Area: Institutionalization

<i>goals</i>	<i>results</i>
<u>1995-1996</u> training courses related to activities at the initial project sites are available.	generally accomplished. Courses on mortgage, construction period, and infrastructure finance, implementation of maintenance competitions and creation of condominiums offered by national organizations. Courses on training of managers for condominiums available in 2 cities at end of first year; in all cities 3 months later.
<u>1996-1997</u> 1. Russian staff capable of continuing all of previous year's activities 2. Training courses related to activities in additional project sites available 3. Training to build capacity for a team of Russian staff/ organization able to extend this program to other geographic regions is available	accomplished accomplished accomplished
<u>1997-1998</u> Year-on-year 100 percent increase in IUE funding from sources other than contracts with the Urban Institute	accomplished

Area: Small Grants Program

<i>goals</i>	<i>results</i>
<u>1995-1996</u>	

None defined.	
<u>1996-1997</u>	
1. Complete second round of small grants program	accomplished
2. transfer basic administration to local organization	accomplished; IUE
<u>1997-1998</u>	
Successful competition for 3rd round of grants	accomplished

Table 2.2
Summary of Accomplishments in Meeting the
Performance Standards

<i>area</i>	<i>total goals</i>	<i>goals achieved</i>
Enterprise divestiture & supporting housing reform in the regions ⁷	89	68
Mortgage and construction period finance	13	11
Infrastructure finance and regulation	15	14
Housing and land policy	5	5
Institutionalization	5	5
Small grants program	3	3
Overall	130	111

⁷ Each goal for each city is counted as a separate goal.

Other Measures

This section briefly reviews four further indicators of the project's productivity: (1) the number of reports, guidelines, etc. produced, (2) the number of seminars in which the team participated or organized, (3) the creation of a home page by the Institute for Urban Economics, and (4) the number of study visits organized by the team or with its cooperation. The first three items were key elements in the project's dissemination strategy. In all cases, we review activities through May 1997 when funding from the HSRP I contract was essentially exhausted.

Documents produced. The project placed a premium on two areas which led to a substantial volume of documents being produced by the project: detailed monitoring of the developments in the sector and evaluation of the early implementation of selected reforms; and the aggressive dissemination throughout Russia of guidelines, handbooks and other documents to promote reform.

Table 2.3 gives a summary of the documents produced. A full listing appears in Annex B.⁸

Table 2.3
Summary Tabulation of Documents Produced by HSRP II

<i>subject or type of document</i>	<i>number produced</i>
legal and policy development	8
guidelines and handbooks for local officials, bankers, real estate professionals; courses	28
sector monitoring, evaluation and analyses	18
principal administrative documents	3
total	57

Different documents within a category were targeted to different audiences. Among the sector monitoring reports, for example, were those aimed at informing housing officials of progress of reforms (e.g., the regular reports on the extent of rent increases in different jurisdictions), a series of studies on changes in the operation of the housing market, aimed at the senior policymakers and their advisers, and several longer monographs geared to informing both Russian policy researchers and U.S. and other consultants working on sector reforms.

Altogether the project printed and distributed about 250,000 copies of these documents. Typically, the format was simple and reproduction inexpensive: over the life of the project most printed documents cost less than 50 cents. The most effective distribution vehicle was providing seminar and conference participants packets of documents on the relevant topic. But other distribution schemes were also utilized. Trade associations, such as the Union of Russian Cities (Land Section) or the Association of Russian Commercial Banks requested copies of certain publications for distribution to their members. In the case of a few handbooks--such as the one on administering housing allowances--Minstroï requested sufficient copies for all major local governments in the country as well as regional governments.

⁸ In the annex, HSRP I documents are those assigned the project number 6306, the internal Urban Institute project number.

During the last half of the project, HSRP employed a full-time Russian public relations officer to help organize the printing and distribution of these documents.

Seminars and courses. The project believed it essential to explain in person housing reforms to housing and real estate professionals and local officials to the maximum degree permitted by the available staff resources. The term "seminar" covers several types of presentation: the project providing a speaker to a conference organized by others, a seminar or conference in which HSRP was a principal organizer, or actual training courses, often of several days duration. A cardinal principle of the project was to organize seminars with Russian organizations--mostly local or regional governments, national ministries and trade associations. The benefits were assistance with the logistics of conference organization and a commitment to attracting participants. Importantly, Russian staff carried almost the whole burden of making the presentations.

Summary statistics on project seminars are presented in Table 2.4 (details are in Annex A^{*}). The data attest to the fact that the project ran a high volume, varied seminar operation. Over the life of the project, there was approximately one seminar every week. Seminars were held throughout Russia, as suggested by the maps presented in chapter one; and, the project worked with a wide range of cosponsors to generate interest in the events and reduce its work burden.

Table 2.4
Summary Data on Project Seminars

<i>category</i>	<i>number</i>
total number of seminars	186
total number of participants	14,630
total number of different cities in which seminars were held	54

Home Page. In the spring of 1996, within its first year of existence, the Institute for Urban Economics established a home page on the internet (www.furbin.ru). Initially, it provided only basic information about the Institute and its publications. Over time, however, the contents--especially of the Russian language version--have been expanded to include a list of upcoming seminars, a current list of new project reports, a set of ordinances adopted by local governments necessary for the implementation of housing reforms (selected by the HSRP team as good examples), and the first sub-Federal bond credit ratings prepared by IUE. The ordinances can be downloaded and readily edited by local governments.

The availability of these resources on the home page is advertized in materials distributed at seminars and in a special insert in the Institute's *Annual Report*. Not many local governments have direct access to the internet. So in some sense the home page is a bit ahead of its time. On the other hand, many local governments have access to an institution--typically a research institute or university--that is connected to the internet. Hence, use is possible. The Institute is monitoring utilization so it can make informed decisions about the amount of resources to devote to this vehicle in the future. Currently there are about ten visitors to the site per day.

Study visits outside of Russia. Study visits can be an important ingredient in the technical assistance mix. The project used these visits for two principal purposes. One was to give a concrete illustration of certain innovations where examples were utterly lacking in Russia. Examples in this

^{*} HSRP II events begin in September 1995

category include early visits on mortgage lending to the U.S., a later visit to Hungary to see how the "dual rate mortgage" was being administered by the OTP Bank, and visits to the U.S. on the development of housing codes. The other was to supplement the education of bankers and officials who had already received some training through HSRP in Russia.

Table 2.5 gives the basic statistics on the use of study visits within HSRP II. There were fewer study tours during HSRP II than during the previous project, owing in part to the reduced need to demonstrate new practices for the first time--examples were now available in Russia--and in part because of lower funding from sources other than HSRP itself. As the table shows, training was concentrated in the finance area where construction period finance and secondary mortgage facilities were completely new topics⁹.

Table 2.5
Summary Data on Study Tours

<i>statistic</i>	<i>number</i>
number of study tours	11
study visits by subject area	
-- finance	7
-- housing maintenance and management ^a	1
-- legislation development	1
-- other	2
number of participants	66
number of cities from which participants were drawn	6
number of different visit/course organizers	5

a. Includes condominiums.

⁹ Details are provided in Annex C. HSRP II tours are from September 1995.

PART II

PRINCIPAL ACTIVITIES

3. Development of National Legislation

The primary stage of establishing a legislative basis for housing reform implementation from 1992 to 1995 saw elaboration and adoption of the Russian Federation Laws “On Fundamentals of Federal Housing Policy,” “On Privatization of the Housing Stock in the Russian Federation,” and the first part of the Civil Code of the Russian Federation. These created a legal foundation for the acquisition of privately owned housing. However, the problems of managing the common property of multi-family blocks under several housing owners, establishing a system of real estate rights registration for all real estate rights and encumbrances, and providing all participants in the real estate market with information necessary for its effective functioning still existed. In addition, legal relations under mortgage lending were not adequately covered under legislation.

The legislative foundation necessary for the transition to market-based relations and successful reform of the housing sector was mostly created from October 1995 to October 1998. It closed the abovementioned legislation gaps and was consistent with the legislative development initiated already in 1992.

The activity of the HSRP team in the development of legislation was focused on key components. The following federal laws were developed with its direct participation:

- “On Homeowner Associations”;
- “On State Registration of Real Estate Rights and Deals with Real Estate”;
- “On Mortgage (Real Estate Pledge)”;
- “On Making Changes and Additions to the Russian Federation Law ‘On Fundamentals of the Federal Housing Policy’”;
- Housing Code of the Russian Federation;
- “On Making Changes and Additions to the ‘Housing Code of the RSFSR’”;

In addition IUE participated in development other federal laws regulating legal relations in the housing sphere:

- “On Allocation of Housing Subsidies between the Regions of the Far North and Areas with Status Similar to Them in 1996”;
- “On Making Changes to the Russian Federation Law ‘On Value Added Tax’” and suggestions to the Tax Code Draft (in part related with setting up a fair taxation environment for independent housing maintenance organizations (including private);
- “On Making Changes and Additions to the Russian Federation Law ‘On Housing Stock Privatization in the Russian Federation.’”

This chapter gives an overview of legislative accomplishments at the national level and the project’s involvement in them.

Legislative Overview

A full list of legal acts is provided in Table 3.1 at the end of chapter.¹⁰ Of the enumerated

¹⁰ The project also produced a summary of relevant laws on housing and real estate each six months. The final edition is S.Butler, “Summary of Laws and Other Legal Acts on Housing and Real Estate in the Russian Federation.” Moscow: Urban Institute Technical Cooperation Office, 1998

legislative acts, the laws “On State Registration of Real Property Rights and Deals with Real Estate,” “On Housing Owner Associations,” “On Making Changes and Additions to the Russian Federation Law ‘On Fundamentals of the Federal Housing Policy,’” and “Allocation of Housing Subsidies between the Regions of the Far North and Areas with Status Similar to Them in 1996” were adopted and enacted.

The federal law “On Mortgage (Real Estate Pledge)” was passed by the Russian Federation State Duma on 24.06.97 and turned down by the President of the Russian Federation on 27.07.97. The President’s veto was finally overridden in July 1998.

The federal draft law “On Making Changes and Additions to the ‘Housing Code of the RSFSR’” is going through a preparatory stage and will be discussed in the first State Duma hearing. It incorporates a new revision of the Code, adopted in 1984, with a number of provisions from the project of a new RF Housing Code developed by the Institute. The most important addendum is the restriction on access to free social housing to certain population categories. This provision could be incorporated in a separate piece of legislation, not waiting until the comprehensive new Housing Code is elaborated. Collaterally, in the nearest future, the work on the new Housing Code of the Russian Federation will be resumed (it was halted in 1996 pursuant to a decision by the Russian Federation Government).

The Federal law “On Making Changes and Additions to the Russian Federation Law ‘On Housing Stock Privatization in the Russian Federation’” is also being reviewed by a conciliatory commission of the Federal Assembly and the President of the Russian Federation.

Project Role

The HSRP team took part in preparing the abovementioned legislative acts and of a whole number of decrees by the President of the Russian Federation, resolutions by the Government of the Russian Federation, and federal programs and normative acts by the Gosstroy of Russia.

The documents that the team helped to prepare included the following:

The federal law “On Home Owner Associations” replaced the Interim Provisions on Condominiums approved by presidential decree as of 23.12.93 #2275. By incorporating a number of standards from the Interim Provisions the law complemented and widely extended them. The law described the methods of condominium management, rights of ownership to the premises and common condominium property, rights and duties of association members, procedure of organizing homeowner associations and their activities, procedure of association registration, defined the purposes for which association-owned property could be pledged as loan security, envisaged preservation of subsidy payments for maintenance of the condominium buildings and described in more detail the rights and duties of the association in property management and procedure of association liquidation.

As a result of the HSRP team’s participation in development of the Law’s provisions, a resolution was passed by the Russian Federation Government “On Approval of Provisions ‘On Determination of the Size and Conditions of Land Plot Borders in Condominiums’” as of 26.09.97 #1223 that established the order of determining the size and borders of land plots conveyed to or leased out to householders or Homeowner Associations. Drafts were also prepared of the Model Charter of the Homeowner Association based on the Law and Resolutions by the Russian Federation Government, wherein the Gosstroy of Russia is given responsibility for development and approval of a single form for registration certificates for house ownership and their release.

Executive bodies of the Russian Federation’s subjects and local authorities were given responsibility for provision of conditions for reregistering and coordinating the constituent documents of the real estate owner associations with the law “On Homeowner Associations.” To further implementation, the Gosstroy of Russia prepared and issued Orders #17-20 “On Approval of a Tentative Contract for Servicing Common Condominium Property” and #17-21 “On Approval of a Tentative

Contract on Targeted Budget Financing of Homeowner Associations” both of 23.05.97, #17-142 “On Approval of Recommendations for Homeowner Associations on Establishing Accounting and Bookkeeping” as of 14.07.97. Those documents were also elaborated with the Institute’s participation.

The federal law of 21.07.97 #122-FZ “On State Registration of Real Estate Rights and Deals with Real Estate” laid down that pursuant to the law on state registration of rights to real estate origination, limitation (encumbrance), conveyance or termination will be put into effect throughout the whole territory of the Russian Federation in accordance with the system of records in the Unified State Register of Real Estate Rights by justice institutions. The law establishes that state registration is the only proof of a registered right, determining the open character of information on state registration and order of its receipt, and determining the order of real estate rights registration. The law determined the specific character of state registration of separate kinds of real estate rights like rights to enterprises, property complex, real estate rights in condominiums, common ownership rights, rights to newly created real estate, lease rights, servitudes, mortgages, trust management, and other rights.

The federal law “On Mortgage (Real Estate Pledge)” lays down more comprehensive requirements for mortgage contracts and order of their registration, defines secured mortgage claims, introduces institution of a pledge attesting the rights of a pledgee on a secured mortgage commitment and on a mortgage contract and not requiring a notarial certificate in case rights on it are conveyed, stipulates the consequences of recovery against pledged property on previous mortgage contracts, leases, servitudes, right to using the premises by the family of the owner, establishes the order of recovery against pledged property and its implementation, defines grounds which give a pledgee a right to claim advanced fulfillment of the secured mortgage commitment, determines the order of transfer of pledged property rights to other persons and encumbrance of this property with the rights of other persons and regulates the subsequent mortgage. The law set that in the case of recovery against pledged housing, the pledger and his family are obliged to vacate the premises on condition that the housing was pledged on mortgage contract to secure payment of the loan given for its acquisition or construction and the family of the pledger had given a notarized certified commitment to vacate the pledged premises in case of recovery against it before the mortgage contract was signed.

The work in this field continued to result in the development and adoption of the Russian Federation Government’s Provisions of 26.08.96 #1010 “On the Agency for Housing Mortgage Lending” that determined the terms and order of establishing the Agency - a specialized secondary mortgage market institution.

The federal law of 21.04.97 #68-FZ “On Making Changes and Additions to the Russian Federation Law ‘On Fundamentals of the Federal Housing Policy’” incorporated changes and additions aimed at matching the concepts and provisions of the Law “On Fundamentals of the Federal Housing Policy” with the Federal Law “On Homeowner Associations.”

The federal law as of 17.08.96 #116-FZ “On Allocation of Housing Subsidies Between the Regions of the Far North in 1996” specified the procedures for allocation of 1996 federal budget funds for granting housing subsidies to the citizens leaving the regions of the Far North for regions with favorable climates. The law prescribes the use of up-front subsidies to the citizens for housing construction and acquisition; and it specified the amount of subsidies as well as loan terms and procedures of granting them.

In addition, the concept of housing subsidies for construction and acquisition of housing was developed in the following normative documents prepared with active Institute involvement:

- Decree by the President of the Russian Federation “On State Support of Citizens in Housing Construction and Acquisition” (adopted on 29.03.96 #430), establishing the mechanism for financial support of citizens in housing construction and acquisition with the help of budget funds through granting free subsidies;

- Resolution by the Russian Federation Government “On Granting Russian Federation Citizens in Need of Improved Housing Conditions a Free Subsidy for Housing Construction and Acquisition” (adopted on 03.08.96 #937), that set the procedures of granting citizens in need of improved housing conditions free subsidies for housing acquisition and construction.

In addition, following an assignment by Gosstroy, the team developed “Recommendations on Development and Implementation of the Program for Granting Free Subsidies (Financial Assistance) for Housing Acquisition and Construction to the Citizens in Need of Improved Housing Conditions.” The Gosstroy forwarded the projects to the subjects of the Russian Federation.

The project of the Russian Federation Housing Code was developed by the HSRP team at Gosstroy’s request as an alternative to the project developed by the Russian Ministry of Justice. The Housing Code envisages another form of state participation in improving housing conditions for its citizens. Unlike the official version, stipulating only provision of living accommodation to those needing improved housing conditions under social rent (*naim*) contracts, the Code has added provisions on assisting citizens to exercise their right to housing through a wide range of instruments which assume certain extents to citizens’ uses of market solutions (giving subsidies for housing construction and acquisition, free land plots for housing construction). It introduces differentiation of citizens according to their right to receive living accommodation under the social *naim* contract, describes the categories of citizens eligible to obtain housing under *naim* agreement based on provisions of article 40 of the Constitution. It lays down that a compulsory social *naim* contract must be signed and claims that its status is superior to that of a warrant. There is a more comprehensive description of the social contract contents, procedure of its signing, changing, canceling and recognizing its invalidity and description of procedures of giving housing accommodation under *naim* agreement.

The HSRP team took the lead in developing a number of legal acts aimed at fostering competition in rendering housing services, regulating the system for utility payments and setting federal standards for the transition to the system. The following documents show positive results of a series of demonstration projects initiated by the Institute.

1. Presidential decree of 29.03.97 #432 “On Development of Competition in Rendering Services in Maintenance and Renovation of the State and Municipal Housing Stocks” recommended executive bodies of the Russian Federation’s subjects and local authorities divide in 1996 the functions of the customer and contractor in maintenance and renovation of the state and municipal housing stocks and transition to contractual relations between organizations performing these functions.
2. Resolutions by the Russian Federation Government of 13.06.96 #707 “On Regulating the System for Utility Payments” established the structure of resident payments for all forms of housing ownership and the procedure of granting compensations (subsidies) for utility payments to the citizens and gave local authorities a right to approve normatives on housing and communal service consumption and rates and tariffs on utility services.
3. The Resolution of 26.05.97 #621, “On Federal Standards of Transition to the New System of Utility Service Payments,” established federal standards of social housing space, the level of citizens’ payments, maximum allowed share of the citizens’ own expenses for utility payments in the aggregate family income, maximum monthly cost of rendered housing and communal services per one sq. m. of the total housing space, which will serve as a base for the annual assessment of the amount of financial assistance provided to the subjects of the Russian Federation from federal budget funds.
4. The Resolution by the Government of the Russian Federation “On Approval of the Federal Standards for Transition to the New System of Utility Services Payments for 1998” set federal standards for 1998 as well as the Procedure of Laying Down Federal Standards for Transition to the New System of Utility Payments and Amounts of Transfers, if the federal

standards and tariffs approved by the Federal Energy Commission of the Russian Federation are observed.

The federal law “On Making Changes and Additions to the Russian Federation Law ‘On Housing Stock Privatization in the Russian Federation’” incorporates standards aimed at establishing additional social guarantees in housing privatization, enables the subjects of the Russian Federation to set terms of privatization completion and establishes the procedures, conditions and terms of housing accommodation in communal apartments, lays down the procedure of housing deprivatization and grounds to make one eligible for recurring privatization.

The federal draft law “On Making Additions to the Russian Federation Law ‘On Value Added Tax’” and suggestions pertaining to the Tax Code Project put forward the idea of exempting the value added tax from housing payments, including rents under naim agreement in the State and Municipal Housing Stock, as well as maintenance fees for housing accommodation maintenance and renovation, common elements, adjacent territories by owners of the housing accommodation and itemized jobs on maintenance and renovation of the housing stock performed by contractor organizations under contract with customer organizations. This would give the same tax advantages to firms working under contracts with municipal organizations as those enjoyed by municipal departments.

The Institute also took part in elaborating a number of federal programs such as:

- federal targeted program “Your Own Home”;
- federal program for demonopolization and development of competition on utility services market for 1998-1999;
- federal targeted program “State Housing Certificates” (by decree of the President of the Russian Federation as of 28.01.98 #102, the program was given Presidential status);
- state targeted “Program for Providing Servicemen and Interior Bodies’ Staff and their Families with Housing in 1998-2002”.

To implement the program “State Housing Certificates” a package of normative documents was worked out:

- Provisions on procedures of preparing and conducting the competition for choosing the General Manager of the Presidential Program “State Housing Certificates,” approved by order of the Gosstroy of Russia as of 25.02.97 #17-45;
- Order by the Gosstroy of Russia as of 25.02.97 #17-45 “On Approval of the Commission for Conducting a Competition for Choosing the General Manager of the Presidential Program “State Housing Certificates”;
- issue and redemption of state housing certificates given to servicemen, citizens dismissed from military service, and citizens subject to move from closed and isolated military settlements, approved by resolution of the Russian Federation Government as of 21.03.98 #320;
- Resolution by the Government of the Russian Federation as of 21.03.98 #320 “On Measures for Implementation of the Presidential Program ‘State Housing Certificates’”;
- Provisions on organizing the competition for selecting banks to participate in the federally-targeted program “State Housing Certificates “ of 27.03.98 # 15H, approved by order of the Ministry of Finance.

The HSRP team took an active part in developing the Concepts of Housing and Utility Service Reform in the Russian Federation, approved by decree of the RF President #425 on 28.04.97. Continuing this activity, HSRP participated in preparing Presidential Decree #528, as of 27.05.97, “On Additional Measures on Utility Service Reform in the Russian Federation,” Resolution by the RF Government of 13.06.97 #702 “On Approving a List of Towns for Tuning the Mechanism of

Implementing Utility Service Reform,” draft of the RF Government Resolution “On Audit of Utility Service Tariffs,” Order by the Gosstroy of Russia #17-142 “On Approval of Tariff Audit Procedure in Organizations Rendering Utility Services” as of 29.12.97, normative and methodical materials on Implementation of the Concepts of Utility Service Reform in the Russian Federation (approved at the meeting of the interdepartmental board of the Council for Architecture, Construction, and Utilities on 29.05.97), draft of the Provisions on Procedure of Developing, Reviewing and Approving Utility Service Tariffs (to be approved via the Gosstroy Order).

The Future

While a great deal has been accomplished, the legal base is far from perfect. Priority tasks for the future include:

- finalizing the Federal Draft law “On Making Changes and Additions to the ‘Housing Code of the RSFSR’” and submitting it for State Duma approval;
- participating in elaboration of the new Housing Code of the Russian Federation;
- taking part in developing the federal draft law “On Making Changes and Additions to the Federal Law “On Homeowner Associations” in the context of the Constitutional Court acknowledging the provisions of articles 32 and 49 of the Law not in accordance with the Constitution;
- providing for further mortgage development, whereby it is necessary to work out a number of normative acts, including the draft of the resolution by the Russian Federation Government on Making State Guarantees on the Funds Attracted by the Agency for Housing Mortgage Lending to Refinance Long-Term Housing Mortgage Loans, Procedure and Conditions of Securing Return of Monetary Funds Given to the Agency for Housing Mortgage Lending with a View for Developing the System of Long-Term Housing Mortgage Lending to the Residents, Procedure of Registering Rights to Uncompleted Construction Objects and Deals with them;
- developing Procedures for Transfer of Non-Housing Stock Owned by the State or Municipalities for Management of Homeowner Associations, Procedures of Granting Subsidies Envisaged by Law to Homeowner Associations and Compensations (Subsidies) and Benefits to Homeowners Living in Houses Managed by Homeowner Associations and a Tentative Procedure of Registration and Issue of Land Titles to Members of Homeowner Associations.

Table 3.1

**List of Legal Documents that were Developed with the Participation
of the HSRP team in 1996- 1998**

1. Federal Laws
 - 1.1. Federal law of 15.06.96 #72-FZ “On Homeowner Associations.”
 - 1.2. Federal law of 21.07.97 #122-FZ “On State Registration of Real Property Rights and Deals With It.”
 - 1.3. Federal law of 26.06.97 #102-FZ “On Mortgage (Real Estate Pledge).”
 - 1.4. Federal Law of 17.08.96 #116-FZ “On Allocation of Housing Subsidies between the Regions of the Far North and Areas with Status Similar to them in 1996.”

- 1.5. (d) Federal Draft Law “On Making Changes and Additions to the Russian Federation Law ‘On Fundamentals of the Federal Housing Policy.’”
 - 1.6. (d) Federal Draft Law ”On Making Changes and Additions to the Russian Federation Law ‘On Housing Stock Privatization in the Russian Federation.’”
 - 1.7. (d) Federal Draft Law “On Making Additions to the Russian Federation Law ‘On Value Added Tax.’”
 - 1.8. (d) Draft of the Russian Federation Housing Code.
 - 1.9. (d) Federal Draft Law “On Making Changes and Additions to the ‘Housing Code of the RSFSR.’”
 - 1.10. (d) Draft of the Tax Code Project (provision 15 of point 2).
 - 1.11. (d) St. Petersburg Draft Law “On Housing Policy in St. Petersburg.”
 - 1.12. (d) Moscow Draft Law “The Housing Code of the City of Moscow.”
 - 1.13. (d) Recommended (Model) Draft Law “On Natural Local Monopolies.”
-
2. Presidential Decrees
 - 2.1. Decree by the President of the Russian Federation as of 29.03.96 #430 “On State Support of Citizens in Housing Construction and Acquisition.”
 - 2.2. Decree by the President of the Russian Federation as of 29.03.96 #431 “On the New Stage in Implementation of the State-Targeted Program “Zhilische” (See p.4.2).
 - 2.3. Decree by the President of the Russian Federation as of 29.03.97 #432 “On Development of Competition in Rendering Services in Maintenance and Renovation of the State and Municipal Housing Stocks.”
 - 2.4. Decree by the President of the Russian Federation as of 21.07.97 #425 “On Utility Service Reform in the Russian Federation.”
 - 2.5. Decree by the President of the Russian Federation as of 27.05.97 #528 “On Additional Measures on Utility Services Reform in the Russian Federation.”
 - 2.6. (d) Blueprint decree by the President of the Russian Federation “On Approval of a Model Charter for Homeowner Associations.”
-
3. Resolutions of the Russian Federation Government
 - 3.1. Provisions by the Russian Federation Government of 26.08.96 #1010 “On Agency for Housing Mortgage Lending.”
 - 3.2. Resolution by the Russian Federation Government of 13.06.96 #707 “On Regulating the System for Utility Payments.”
 - 3.3. Resolution by the Russian Federation Government of 27.06.97 #753 “On Federal Targeted Program ‘Your Own Home’ (See p.4.1).
 - 3.4. Resolution by the Russian Federation Government of 03.08.96 #937 “On Granting Russian Federation Citizens in Need of Improved Housing Conditions a Free Subsidy for Housing Construction and Acquisition.”
 - 3.5. Resolution by the Russian Federation Government of 26.05.97. #621 “On Federal Standards of Transition to the New System for Utility Payments.”

- 3.6. Resolution by the Russian Federation Government of 13.06.97 #702 “On Approving a List of Towns for Tuning the Mechanism of Implementing Utility Service Reform.”
 - 3.7. Resolution by the Russian Federation Government of 26.09.97 #1223 “On Approval of Provisions ‘On Determination of the Size and Conditions of Land Plots’ Borders of Condominiums.”
 - 3.8. Provisions by the Russian Federation Government as of 20.12.97 # 1613 “On the Program for Demonopolization and Development of Competition in the Utility Service Market” (See p.4.5).
 - 3.9. Resolution of the Russian Federation Government of 20.01.98 #71 “On Federal Targeted Program ‘State Housing Certificates’ (See p.4.3).
 - 3.10. Resolution of the Russian Federation Government of 30.05.98 #536 “On Approval of the Federal Standards for Transition to the New System of Utility Service Payments for 1998.”
 - 3.11. Resolution by the Russian Federation Government as of 21.03.98 #320 “On Measures for Implementation of the Presidential Program ‘State Housing Certificates.’”
 - 3.12. Resolution by the Russian Federation Government #630 of 24.06.98 “On Social Protection of Population under the Revision of Prices for Natural Gas.”
 - 3.13. Decree by the Russian Federation Government #581 as of 11.07.98 “On Amendment to the Procedure of Issuance and Redemption of State Housing Certificates for Servicemen Retired or Dismissed from Military Service and Citizens of Closed Settlements Subject to Removal.”
 - 3.14. (d) Draft Resolution of the Russian Federation Government “On Carrying Out an Obligatory Expertise of Tariffs for Goods, Works and Services Taken into Account in Paying for Housing and Utility Services.”
4. Federal Programs and other documents approved by the Russian Federation government
- 4.1. Federal Targeted Program “Your Own Home.”
 - 4.2. Main directions of a new stage of implementation of the State-targeted program “Zhilische.”
 - 4.3. Federal Targeted Program “State Housing Certificates.”
 - 4.4. State Targeted Program for Providing Servicemen and Interior Bodies’ Staff and Their Families with Housing in 1998-2002.
 - 4.5. Federal Program for Demonopolization and Development of Competition on the Utility Service Market for 1998-1999.
 - 4.6. Procedure of Laying Down Federal Standards for the Transition to a New System of Utility Payments and Amounts of Transfers Given that the Federal Standards and Tariffs Approved by the Federal Energy Commission of the Russian Federation are Observed (approved on 04.08.97 by the Head of the Government Commission on Reforming Municipal Infrastructure in the Russian Federation and First Deputy of the Head of the Russian Federation Government B.J.Nemtsov).
 - 4.7. Issue and redemption of state housing certificates given to servicemen, citizens dismissed from military service, and citizens subject to move from closed and isolated military settlements (approved by resolution of the Russian Federation Government as of 21.03.98 #320).

5. Departmental normative documents
 - 5.1. Gosstroy Order of 23.05.97 #17-20 “On Approval of a Tentative Contract for Servicing Common Condominium Property.”
 - 5.2. Gosstroy Order of 23.05.97 #17-21 “On Approval of a Tentative Contract on Targeted Budget Financing of Homeowner Associations.”
 - 5.3. Gosstroy Order of 14.07.97 #17-45 “On Approval of Recommendations for Homeowner Associations on Establishing Accounting and Bookkeeping”.
 - 5.4. Gosstroy Order of 29.12.97 #17-142 “On Approval of Tariff Audit Procedures in Organizations Rendering Utility Services.”
 - 5.5. Normative and methodical materials on implementation of the concepts of Utility Service Reform in the Russian Federation (approved at the meeting of the interdepartmental board of the Council for Architecture, Construction, and Utilities on 29.05.97).
 - 5.6. Provisions on procedures of preparing and conducting the competition for choosing the General Manager of the Presidential Program “State Housing Certificates” (approved by order of the Gosstroy of Russia as of 25.02.97 #17-45)
 - 5.7. Gosstroy Order of 25.02.98 #17-45 “On Approval of the Commission for Conducting a Competition for Choosing the General Manager of the Presidential Program “State Housing Certificates.”
 - 5.8. Provisions on organizing competitions for selecting banks to participate in the federal targeted program “State Housing Certificates” (approved by order of the Ministry of Finance as of 27.03.98 #15H).
 - 5.9. (d) Blueprint of Provisions on Order of Development, Review and Approval of Utility Service Tariffs (to be approved by Gosstroy Order).

4. Housing Divestiture and Work with Regional Cities

The objective of this chapter is to document the activity carried out by Urban Institute-HSRP staff with regard to enterprise housing divestiture during the 1995-1998 period. The Chapter will detail work in the targeted cities of the program. It provides an assessment of the impact of team activities on privatization, condominium formation and other issues addressed under the programs.

Project Overview

HSRP II was initiated in October 1995, with the signing of a contract between the US Agency for International Development (USAID) and the Urban Institute for certain extensions to the overall work program beyond HSRP I and for a concentrated effort in four sites: Moscow, Nizhni Novgorod Oblast, Vladimir Oblast and Ryazan. In terms of the specific goals set for the project, in addition to a few life-of-project indicators, new performance indicators were determined for the project each year as part of the annual work plan.

The theme of the overall program was to encourage cities to accept more housing from enterprises ready to divest their units by helping cities cut the subsidies associated with operating their stock. To do this, the Urban Institute team worked in three directions in each city: (1) designing phased increases in housing rents paid by tenants and at the same time strengthening the housing allowance programs; (2) improving the efficiency of the maintenance and management of the municipal housing stock (including divested buildings) by selecting maintenance firms through competitions and thereafter monitoring their performance closely, and by the formation of condominiums whose members will have a strong interest in good management for their buildings (promotion of unit privatization is a necessary antecedent to condominium formation in many buildings); and, (3) working with the city to design and finance energy efficiency enhancing investments for the housing stock.

HSRP also initiated work with cities participating in the World Bank's Enterprise Housing Divestiture Project (EHDP) during 1995 at USAID's direction. The participating cities included Vladimir and Ryazan from the HSRP list, plus Orenburg, Volhov, Petrozavodsk, and Novocherkassk (later replaced with Cherepovets).¹¹

It is worth noting that the World Bank set specific reform targets for the cities to meet, by the end of calendar year 1996, in order to remain eligible for continuing investments under the program. These targets included:

1) Divestiture. Complete divestiture of 90 percent of enterprise housing stock eligible for divestiture by the end of 1996 (100 percent by the end of 1997) together with corresponding utility networks.

2) Competitive Maintenance.

a. Place at least 10 percent of total housing stock under competitive maintenance.

b. Undertake the following structural reforms in order to de-monopolize the maintenance market:

Reorganize structures (both municipal maintenance organizations and maintenance departments divested from enterprises) which provide housing maintenance services into legal entities.

Liquidate management structures which serve as intermediaries between single Customer

¹¹ PADCO worked with Orenburg during the initial stages of the project.

Service agencies and organizations which provide maintenance services.

c. Improve procedures and legal mechanisms for competitive tenders for maintenance services based on experience to date.

d. Establish clear and transparent frameworks for financial and legal relations with winners tenders.

3) ***Condominium Formation.*** Give condominiums the legal and actual to own both commercial real estate located in their buildings as well as surrounding land.

4) ***Cost Recovery***

a. Achieve 60 percent cost recovery, as long as the number of housing allowance recipients remains less than 25 percent of households in the city. The eligibility threshold level of household income for housing and utility payments was set at 15 percent.

b. Ensure sufficiency of the institutional and administrative capacity of the housing allowance system via the following:

- Consistently provide information on the housing allowance system in a city, including criteria of eligibility for housing allowances, application procedures, and contact persons;
- Ensure that the number and location of branch offices of the housing allowance service are sufficient to accommodate applicants in a timely manner; and
- Build in flexible hiring mechanisms for temporary expansion of housing allowance services to avoid lines following tariff increases.

Under HSRP II, the Urban Institute assisted the EHDP cities to meet the conditions for inclusion in the World Bank program. The Institute's activities in support of EHDP have centered around assisting cities in the areas of:

- Completing divestiture of targeted percentages of enterprise housing stocks;
- Privatizing housing maintenance;
- Encouraging the privatization of units;
- Creating and implementing the legal foundations for formation of condominiums;
- Assisting the cities to devise and implement policies on increasing recovery of maintenance and utility costs;
- Working with cities to strengthen and revise housing allowance programs to mitigate the effects of increased cost recovery on poor households.

These tasks closely parallel the activities that HSRP II calls for in Moscow, Nizhni Novgorod Oblast, Ryazan and Vladimir Oblast. In fact, two of the HSRP II target cities, Ryazan and Vladimir, are included as eligible under EHDP. Finally, similar but more limited assistance was provided to Moscow and Nizhny Novgorod, partially with HSRP I funding.

The highlights of the program for 1996-1997 can be encapsulated as follows:

- enterprise housing divestiture
- introduction of competitively selected firms to maintain and manage the municipal housing stock, and
- formation of condominium associations

The number of cities receiving on-site technical assistance expanded to 12-13. Greater emphasis was placed on training activities--both in Moscow and the regions and staff was available in Moscow to consult with officials from regional cities.

Four of the cities were defined as Regional Centers. These Centers were deliberately chosen to extend the reach of reforms into areas previously comparatively under served by the Housing Sector Reform Program. Each Regional Center served as a "hub" for regional training activities. Officials from surrounding regions were invited to participate in training programs and seminars and project staff was available in each Regional Center for consultation on a regularly scheduled basis. (The reasons for the choice of specific cities are given below.)

Work to be carried out in 1997-1998 under the HSRP II concentrated on:

- Continuation of development of the legal basis for housing reform. (In the project's final eighteen months worked extremely closely with First Deputy Prime Minister Boris Nemstov on policy development).
- Assistance in implementing the array of housing sector reforms in two sets of cities--the six cities included in the World Bank's Enterprise Housing Divestiture Project and the fourteen cities selected by Mr. Nemstov and Minister of Construction, Efim Basin, as pilot reform cities.
- In addition, there was limited work in support of the Moscow pilot program to select private firms for managing municipal housing through competitions.

Activities During the Period

1995-1996. During Year One and Year Two of HSRP II, the Work Plan gave priority to enterprise housing that was about to be transferred to the municipality (i.e. before the buildings got absorbed into the municipal maintenance system) because we believed that this minimized resistance from the maintenance and housing departments in the local administrations. Depending on the pace of divestiture we encouraged cities to work more or less extensively with buildings that already had been transferred. Work also continued with housing that had already been absorbed by the cities to encourage condominium formation and competitive maintenance offerings. In Moscow, where the city refused to accept more divested housing until Federal subsidies again began to flow, emphasis continued to be exclusively on already-divested buildings until such time as the city began to accept new units of departmental stock.

The unit privatization and condominium registration marketing and training campaign begun during Year One continued in Year Two, with a significant change in that it was directed by the cities themselves, instead of Institute staff. Institute staff trained city officials in the techniques of the promotional program. City staff then continued the process. During Year One, the project tried the approach of targeting specific buildings for an intensive campaign of information through the distribution of flyers in mail boxes and the placing posters in entryways, and organizing meetings for tenants in the buildings, in addition to mass media promotion of unit privatization and condominium formation. The impact of these initiatives was carefully tracked and the results found to be disappointing in terms of increased privatization and condominium formation. Therefore, in Year Two the recommended approach was amended away from this labor intensive one to one in which reliance was on mass media and strong follow-up by local officials to inquiries from tenants and condominium initiative groups.

EHDP (and RF law) called upon target cities to establish and fund housing allowance programs to assist poor households deal with the economic pressure of meeting higher rent and communal service cost recovery percentages. All the target cities established such programs. Staff continued to assist the

World Bank cities fine tune their programs and added new components as necessary throughout Year Two of HSRP II.

Competitive Maintenance. Staff worked with the cities to convince them of the need for and benefits of creating customer service entities. These structures enabled the city to clearly separate the functions of maintenance contractor and management (customer service in the role of owner) and to support efforts to implement a competitive process for selection of housing maintenance providers. The creation of both customer service and separate municipal housing maintenance competitions resulted in lower management and maintenance costs and improved housing conditions for residents.

The program team provided assistance to all the target cities and recommended improvements to existing systems to strengthen the maintenance competition process, in particular, as it related to enterprise housing stock. Team activities included evaluation of current maintenance systems and quality, training on formation and continuation of customer service, advice on allocation of expenses between contractors and customer service, development of standardized contracts and inspection techniques and actual involvement in the bidding process.

During the year Moscow pioneered the first competition for management services at the level of the DEZ or Office of Unified Customer.

Program Strategy for stimulating Privatization and Condominium Formation. A key strategic element of the work program from October 1, 1995 to October 1, 1996 was to concentrate available resources on selected "high priority" buildings — former enterprise housing stock which was attractive for unit privatization and possibly condominium formation. Spreading resources more widely was thought to carry the clear danger of not sufficiently alerting tenants to the possibilities of privatization and condominium formation or pushing information at tenants known to have little reason to be interested in those options. Thus, in addition to an operational approach, the team's activities could also be viewed as a test of that approach to determine if this intensive focus of time and resources would be effective in stimulating reforms, and if so, could be used as a model for other regions and cities in their reform programs.

Marketing the Privatization Process. During Year One, UI staff spent considerable time and resources working with the cities to market the privatization process. Because of the reduced levels of effort planned for Year Two, the cities themselves had to carry out this function. UI assisted them with consultations and training as needed. As noted, the approach of targeting an intensive information campaign on selected buildings was not productive. Therefore, the strategy was changed to greater reliance on mass media and strong follow up to inquiries stimulated by the advertising campaign.

Building Selection Criteria and Targeted Enterprises. In each of the four priority cities, the program teams developed lists of target enterprises that recently divested stock to the administration. Staff also identified blocks of buildings that already been divested but that were not previously targeted for UI work. Within these broad parameters, staff then searched for individual buildings or blocks of buildings on which to focus their activity of promoting privatization and condominium formation.

The selection criteria on which to base the initial determination of a building's suitability for activity included:

- **Technical Condition of the Building.** Targeted buildings should be not more than 10 years old. Buildings that were constructed more than 10 years ago could be considered if they had major renovations completed within the last 7 years. Staff looked for buildings in the best condition. They also reviewed building documentation and conducted visual inspections of target buildings to determine if they met these standards.

- **Percentage of Privatized Apartments.** The percentage of privatized apartments should have been more than 30% in target buildings. Staff felt that high levels of privatization would stimulate activity in condominium formation and give residents greater incentive to properly maintain their buildings to improve their future value.
- **Building Location.** Staff looked for buildings located in more prestigious districts. Experience shows that such buildings were traditionally better constructed and maintained, and therefore are easier and more economical to operate. They also prove to be better targets for formation of future condominium associations. This factor can be severely limited if the divested housing is all located in one area and that area is undesirable.
- **Existence of Groups of Residents Showing Interest in Creation of Condominiums.** It is important to the future of any condominium that it contain a group of interested and active people who are willing to push for reform and assist in the management of the condominium.
- **Presence of Non-Residential Areas in Building.** If the building contains non-residential spaces (commercial, potential commercial, or amenities) its value and ability to provide income to the condominium association increases.
- **Condition/Desirability of Adjacent Territories.** Staff looked for buildings to target that had adjacent territories that were desirable and in good condition. Such territories, if allocated to the condominium at registration or in the future, could serve to increase the value of the condominium and may be developed for income purposes.

Staff worked to select target buildings based on the above standards. However, buildings that were selected did not always meet all the selection criteria. Once staff selected target buildings, they began their work to promote privatization of units, condominium formation and competitive maintenance for the buildings. They met with residents to begin training programs, consulted with city officials on registration issues and began advertising campaigns. The amount of time that these efforts took to bear fruit varied widely depending on the attitudes of residents and officials, the local political atmosphere, economic conditions, and the level of reform and legislative base in the city.

Urban Institute staff working with each target city engaged in a wide variety of activities to promote housing reform and accomplish program goals. The principal activities carried out by team members concentrated on hiring and training staff, developing and implementing information campaigns in support of program goals promoted unit privatization and condominium formation, bringing the municipal housing stock under competitive maintenance, assisting cities to increase the percentage of maintenance and utility costs they recover from residents, and helping cities refine their housing allowance programs.

Information Campaigns. The intent of these campaigns was to disseminate as much information as possible to city officials and residents regarding program goals, and to meet and consult with interested parties to discuss issues, problems and potential solutions to those problems.

Prior to February 1996 the team's efforts primarily consisted of meeting with officials and residents to develop working relationships, gathering information about the status of housing reforms in the cities, assessing and selecting target enterprises and buildings, completing other necessary background work, and developing informational materials (advertisements, brochures, fliers, etc.).

Beginning in February and March, field staff began to work with the cities to place advertising materials in local media when possible (TV, radio, print), and to distribute flyers, posters and brochures to buildings selected as targets for action. These materials were developed by the Urban Institute and were intended to stimulate resident interest in privatizing their units and forming condominiums. In each advertising piece or placement, a telephone contact number was listed to which residents could call to receive more information. Staff also gave interviews in the local press and encouraged city officials to publicize program goals.

The major areas of work included:

- Distribution of fliers that encouraged residents to privatize their units and to form their buildings into condominiums. Staff posted fliers at residents' units and handed them out at informational meetings.
- Placing advertising posters to encourage privatization and formation of condominiums. Posters were typically hung in resident buildings, in public buildings and in employment offices where those seeking jobs might be stimulated to consider condominium management or maintenance as forms of employment.
- Distributing brochures developed by the team. Staff had these on display and available at informational meetings held with residents, city officials and other interested parties.
- Holding informational meetings with residents and city officials to educate them about privatization and condominium formation and to solicit their support.
- Showing videos pertaining to apartment privatization and condominium formation to city officials and residents of target buildings. The videos were produced by the Urban Institute.
- Conducting training seminars to teach the practical aspects and advantages of condominium formation, unit privatization and maintenance competition.
- Holding consultations with city administrations, residents and oilier interested parties. Such consultations covered the entire spectrum of program goals including privatization, condominium formation, competitive maintenance, and housing allowance programs.
- Broadcasting television advertisements produced by the Institute that promoted program goals. Included in this category were interviews and other informational activities that appeared on television in support of team efforts.
- Broadcasting radio advertisements produced by the Institute.
- Miscellaneous other activities earned out by staff in support of Institute programs including giving presentations, advertising in print media, reviewing documents, etc.

For the most part, this intensive level of "tenant-to-tenant" activity proved to be ineffective in generating significant numbers of contacts with residents or encouraging them to privatize their apartments. For example, in Moscow, two thousand fliers were distributed throughout one particular region of the city announcing an informational meeting which was to be held on unit privatization and condominium formation. Only four residents showed up for the meeting.

Beginning in March, staff attempted to track the number of contacts received, units privatized and condominiums that have been formed in the cities. From trends in such activity through September, preliminary inferences can be drawn regarding the effectiveness of the information campaign. In summary, Table 4.1, below, shows activity totals from February - June 1996 and numbers of contacts generated. The table shows that in spite of the intensive, broad-based, door-to-door information campaign by UI staff, relatively few contacts occurred. Staff have carefully tracked this data and determined that efforts on information campaigns need to be targeted to those approaches that give the most significant results. Experience has shown that articles in newspapers and advertisements on television and radio tend to generate the greatest response from residents.

Table 4.1
Levels of Activity and Contacts Received February-June 1996

City/ Activity	Moscow	Nizhni Novgorod	Ryazan	Vladimir	Volkhov	Petro- zavodsk	Novo- cherkassk
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Fliers	16,025	520	10,645	9271	2040	691	1094
Ads	764	60	0	190	184	36	79
Brochures	447	30	39	65	56	18	45
Meetings	4	2	0	6	5	6	22
Videos	7	1	24	19	2	0	1
Training	6	-	3	6	1	0	0
Consultation	75	32	31	85	30	32	66
TV Shows	0	1	11	1	0	12	28
Radio	0	0	0	0	1	0	0
Other	18	2	11	3	0	0	0
Number of Contacts	118	47	40	120	32	34	106
Contacts per thousand pop.	.13	.34	.76	3.42	5.33	1.21	5.30

Unit Privatization. One area of activity not specifically addressed in EHDP as a target, but that was a focus of HSRP efforts, is that of encouraging privatization of units. Increased privatization levels are viewed as critical to realizing the creation of condominium associations. Higher privatization rates in buildings usually reflect greater tenant activity and positive attitudes toward reform. Experience shows that tenants in these buildings are more likely to form condominiums.

Generally, unit privatization rates in enterprise housing have been lower than in municipal housing. Nationally at the end of 1994, the rates were 19% and 36% respectively. One reason for the lower rates in enterprise housing was that tenants were often discouraged from privatizing their units by firms wishing to retain ownership and control. Once the housing has been divested to the municipality, there is a good chance the tenant interest in privatizing could be rekindled. On the other hand, the poor condition of much of the enterprise housing works against privatization since the value of the asset "on offer" is less.

Many of the program activities involved promotion and advertising in targeted buildings to encourage residents to privatize their units and/or create condominiums. Therefore, measuring the results of these activities can be general indicator of the impact and effectiveness of Institute advertising and information dissemination programs. Table 4.2, below, shows the level of housing privatization in each of the cities.

Table 4.2
Privatization Levels in Targeted Cities Percent as of Given Date

Municipal Housing Stock				Enterprise Housing Stock		
City	4/1/96	6/1/96	10/1/96	4/1/96	6/1/96	10/1/96
Moscow	41	43	44	34	39	39

N. Novgorod	33	34	34	na	na	na
Ryazan	40	44	45	23	24	24
Vladimir	50	51	52	55	55	56
Volkhov	38	38	38	33	33	34
Petrozavodsk	33	na	36	63	na	63
Novocherkassk	37	na	39	86	na	87

Notes: a. Data for this table comes from the report on the World Bank Enterprise Housing Divestiture Project, the Urban Institute "Housing Sector Reform Project II, Work Plan," and from Urban Institute field staff. b. Nizhni Novgorod has not kept separate data on privatization in enterprise housing. c. Percents shown here for Moscow are from January 1, 1996. Specific data was not available in April 1996.

As can be seen in Table 4.2, privatization levels are generally flat, although slight progress was achieved in most cities, with significant progress in Ryazan's municipal housing stock and Moscow's enterprise housing stock. The reason for the increase in Ryazan is difficult to pinpoint. However, the return of the communists to power in the local city council might have caused residents to "hurry" to privatize now fearing that this option may be taken away by the communists in the future. As for the increase in Moscow, until 1995, there were severe limitations on privatizing apartments in the enterprise housing stock. The increase from 34% to 39% could have been caused by a further easing of these restrictions in 1996, as well as the continuing growth of the overall housing market in Moscow.

The low level of increased privatization in other cities is in spite of the intensive activities of the UI team to advertise and promote privatization. For the most part, however, tenants who saw a benefit of privatizing their apartments have done so. Those living in poor quality housing or in undesirable regions remain hesitant about privatizing their apartments and will most likely remain so, regardless of UI efforts.

1996-1997: Regional Centers

Selection of Regional Centers

The project had three criteria for selecting Regional Centers:

- (1) The city should not have previously been the site of a significant technical assistance program under HSRP.
- (2) The city and oblast administrations should give a clear expression of interest in participating in housing sector reforms, particularly those elements included in the enterprise housing divestiture part of HSRP.
- (3) The city must be a good transportation hub for its region.

The second criteria was given substantial weight for three reasons. First, the HSRP teams visiting the city would have time to work in detail with local officials. If the locality was not ready and willing to work on reforms, some of team's time would be wasted. Second, it was important for the seminars given to participants from the Regional Center and from others parts of the region to take place in a positive, pro-reform atmosphere. Third, some of the seminars work best if the lessons can be illustrated with practical, real world examples *from that region*. Local speakers relating their experiences and

occasional site visits would be very important in "selling" reforms to other participants.

St. Petersburg--Far North Regional Center. While the team would have preferred a true city of the Far North, e.g., Murmansk or Arkhanglsk, these sites proved unworkable because of poor interregional transportation. St. Petersburg was selected because it is a northern city, a good transportation hub, and the site of significant housing sector reform work.

Vladivostok--Far East Regional Center. The choice in this instance was quite simple: it is the only city of the region with which we were well-acquainted, the City was then moving forward on reforms with HSRP assistance and was able to serve as the "working site" for the region.

Since a visit by Struyk, Kosareva, and Suchkov to the city in September 1995, a good but limited working relation had developed between the City Administration and HSRP. A one week visit to Moscow by the deputy head of the Department of Housing and Communal Services followed. Shapiro and Sivaev visited the City the following spring to work intensively on structuring competitive maintenance for the municipal housing stock and condominium formation. Thereafter, delegation of five from the Department of Housing and Communal Services spent two weeks visiting several HSRP II cities to see reform in action. The Deputy Head of the City Administration, Viktor Sugak, sent a letter strongly requesting further help from HSRP. The city is also well connected to the other principal cities of the region.

Irkusk--Eastern Regional Center. Because of the intense activity of the "Eastern" or PADCO portion of HSRP over the previous four years in the Urals-Western Siberia region, the choices among sites was more limited. The team focused on two candidates, both east of Novosibirsk: Irkusk and Krasnoyarsk. Detailed inquiries were made in both cities as the basis for selection.

Irkusk was known to the HSRP team through two channels. First was our direct work with the East Siberian Commercial Bank on all aspects of housing lending and through a 1994 housing finance seminar hosted by the Oblast Administration and the realty firm, "Vincent." Second was the positive reputation the City enjoyed from its participation in other USAID-supported real estate sector projects, including zoning and title registration. An Urban Institute team visited Irkusk in mid-July and received enthusiastic responses from both the Oblast and Municipal administrations at the Deputy Governor and Deputy Mayor level. The Oblast strongly pressed, however, for the team to work with it on preparing a detailed plan for implementation of the financial side of the "Svoi Dom" program, a request that seemed reasonable.

Krasnoyarsk Krai administration had a strong reputation for being progressive in some aspects of housing reform--especially, rent reform and the organization of the housing allowance program. Members of the Krai administration had visited Moscow several times over the previous eighteen months and there was a good working relationship between HSRP and the Administration. These officials pledged their full cooperation if the city were selected as a Regional Center. The Krai is extremely large, and covers an enormous distance north to south. Thus, a full range of climatic conditions, and the associated problems in tariff and rent setting, would be represented. It also contains numerous one-factory towns that pose special problems for enterprise divestiture. On the other hand, municipal administration officials were found to be less interested and it developed that there were some contradictions between oblast and municipal officials. Based on the foregoing, it was decided to select Irkusk.

Rostov-on-Don--Southern Regional Center. The team began with three serious candidates for this center: Astrahan, Rostov-on-Don, and Krasnodar. These cities have in common that they are far to the south, in the so-called "Red Belt." All three are also substantial local transportation centers. Astrahan was eliminated early in the process because of the reputation with Ministroi officials and some people in the region with whom we work of Astrahan's housing officials being distinctly non progressive.

A team from the Urban Institute visited Rostov-on-Don to hold discussions with local officials about their interest in working closely with the HSRP team on housing reform. The response from both Oblast and City officials was positive. Another distinct advantage of Rostov was its proximity to Novocherkassk (40 kilometers). While the program had stopped working with Novocherkassk because it was eliminated as a World Bank housing divestiture loan site,¹² officials there are enthusiastic about continuing cooperation--including being local speakers at regional seminars and the city serving as a demonstration site for housing maintenance reform and condominium creation. Also worth noting is the fact that the oblast voted strongly for Yeltsin in the presidential election runoff, distinguishing it from most of its neighbors.

Based on various contacts with officials from Krasnodar over the past two years, the team had a generally positive view of the administration. Initial phone discussions with officials about serving as a regional center, also were reassuring. However, the time pressure for making a city selection prevented the team from making a separate site visit; and the strong response from Rostov-on-Don made such a visit expendable. Table 4.3 lists the cities to be included as priority sites.

Table 4.3
Principal Sites for HSRP Activity in 1996-97

<i>city group</i>	<i>description</i>
Moscow , St. Petersburg	national priority cities; full program at somewhat reduced level of intensity
Vladimir ,Ryazan ,Nizhni Novgorod	completion of Year One HSRP II activities & maintaining momentum of other reforms; Vladimir & Ryazan are WB divestiture sites
Volkov, Petrozavodsk , Cherepovets Orenburg	World Bank enterprise housing divestiture sites; continue M&M and housing allowance activities
<u>Far East Regional Center</u> Vladivostok <u>Eastern Regional Center</u> Irkusk <u>Southern Regional Center</u> Rostov-on-Don <u>Northern Regional Center</u> St. Petersburg	expanded regional program serving important leading cities "new" to the program; cities will serve as base for regional seminars and training

Regional Centers' activities. During Year Two of HSRP II, the project changed its approach to providing consultations and training to city administrations and Russian professionals interested in discussing housing-related reforms. Four cities were selected as Regional Centers in which to base these efforts. HSRP staff traveled frequently to the Regional Centers to provide consultative services with representatives of city administrations and to organize and conduct training seminars. Cities in each region were notified in advance of HSRP staff visits so arrangements could be made for consultative meetings during the team's presence in the city. In this way, UI invested its limited resources in a more efficient manner to disseminate information to a wider range of cities. This less intensive approach was based on the team's sense that the momentum of reform was now sufficiently great that many local

¹² The Oblast declined to guarantee repayment of the World Bank loan.

officials were "ready" to act and the principal impediment to action was lack of detailed knowledge and concrete examples on how to proceed.

In the initial phase of Year Two, UI staff engaged in a concentrated effort to set up the UI program in the Regional Centers. Staff identified and entered into agreements with logistical coordinators in each of the Regional Centers. These were individuals or institutions depending on the circumstances. Their tasks were to organize the seminars, including making hotel reservations, etc. for those coming from other cities. If necessary, HSRP provided the center with a fax machine to facilitate communications between the center and the HSRP office in Moscow.

In each city, a modest "resource center" was established where a relevant project publications and papers could be found along with information about HSRP staff: who was expert in what, how they could be contacted, and the schedule for the seminars and other team visits. The center included space where the HSRP experts could consult with clients.

During this start up period staff also established mailing lists for the largest fifteen cities in the catchment area of each Regional Center. The lists included officials with the specific responsibilities relevant for the content of each course. A similar list of banks was prepared. Direct mailings were made to these persons. Additionally, prior to the first seminar, staff traveled to municipalities located in the regions covered by the Regional Centers to meet with city officials. The purpose of these visits were to alert the officials to the existence of the Regional Centers, explain their purpose and to encourage the cities to send their representatives to the Regional Centers to engage in consultations and attend training seminars as needed.

The courses were taught by UI staff, at least initially, and stressed the practical techniques of housing management and maintenance and other aspects of reform. UI developed seminars that were targeted to officials and management professionals who were looking for detailed information. In other words, they were advanced, specific courses geared to enhancing the knowledge of qualified managers, rather than some of the broad, general information courses that the UI had offered to date.

Four standard seminars were held in each Regional Center and others were available as demand dictated. The main topics of the seminars were:

Customer Service. Staff discussed the reason for the creation of these entities, their purpose and organization, the separation of management and maintenance functions, funding issues and legal questions.

Maintenance Competitions. Topics included how to organize and conduct fair, impartial competitions including selecting blocks of buildings for inclusion, advertising the competition, bid evaluation and contract negotiations.

Condominium Basics. Covered issues were the Russian Federation Law on Condominiums and its implementation in the cities, formation of condominium boards of directors, condominium finance, charters, and property management issues that are unique to the management of condominiums.

Housing Allowances. Topics included how to establish allowance programs, the legal basis for the programs, and examples of how such programs are successfully administered in other cities.

Housing Finance. Introduction to mortgage lending and construction period finance.

Infrastructure finance. Options for long term finance of infrastructure investments for communal services and related tariff reform questions.

Miscellaneous Seminars on-Demand. The Urban Institute received many requests to present or take

part in seminars and training programs for many bodies interested and involved in the process of housing reform. Staff made some of these presentations in host cities. Examples of such seminars that UI staff conducted in 1996 were seminars on the effective formation and administration of customer service entities; housing inspections; discussions of the law on condominiums; the presidential decree on competitive maintenance and other varied topics. We anticipated that cities from the Far North had a particular interest in programs for relocating families from these cities to those with more temperate climates.

Institute staff and consultants had already developed written materials for a number of these topics that could be distributed in support of the seminars. Also, UI staff had been trained in effective training techniques and could lead discussions on how to more effectively plan and conduct training sessions. During Year Two, staff developed a manual to teach others these effective training techniques.

The audience for most of these seminars was the cadre of local officials directly responsible for a specific area. The exception was the housing finance seminar which was more geared to bankers. It was important as well, however, to reach the public on certain issues. In particular housing privatization and condominium formation were topics of vital importance to the public. As part of the condominium seminar, packages of the advertising materials developed in the past year were given to each city and the ways in which these materials had been successfully used in the past was explained.

The Urban Institute worked with each training partner to ensure that the quality and content of all seminars were consistent with project standards. HSRP had already had good results with this approach, for example, with its training cooperation with the Academy of Entrepreneurship in Moscow. The HSRP team utilized this experience to establish effective working relationships and training programs in the new regional centers.

Complementing the seminars there was a program of consultations. Generally, officials from the region desiring consultation were invited to the Regional Center. However, in exceptional cases and where the city had already demonstrated real progress in a specific area of reform, e.g., holding competitions to select firms for maintaining municipal housing, a team member made a short visit to another city in conjunction with a visit to the Regional Center.

1997-1998. In the current program year, with the lower level of available resources, the program restricted its focus to the two groups of cities listed in Table 4.4 -- the six cities participating in the World Bank's Enterprise Housing Divestiture Project (EHDP) with which the project had already worked for two years and the fourteen cities selected by Mr. Nemstov and Minister Basin in May 1997 as pilot reform cities. The team also continued to provide limited assistance to Moscow on rent reform and housing maintenance and management issues.

The RF Government Resolution #702 as of 06/13/1997 approved the list of cities selected for excising technique of reforming the housing and communal sector within 1997. The list included 14 municipalities representing various regions of Russia. The pilot cities differ in size, climatic conditions, geography, ethnic composition of the population, some other aspects, but according to mid-1997 data, they, first and foremost, differ in their pace of reforming communal sector.

Within second half of 1997, the RF Government requested the USAID Housing Reform Program to provide advisory support on municipal infrastructure reforming to the municipalities listed in the above mentioned Resolution. This was agreed to because this is in general a high USAID priority.

As of July 1997 the cities could be grouped as follows:

- I - cities which managed to develop a complete strategy of municipal infrastructure reform and produce positive results in nearly all lines of the infrastructure reform (Novgorod and Nizhny

Novgorod);

- II - cities where the housing and communal reform became one of the main city's concerns but where the municipality managed to produce positive results only in some of its lines (Saint-Petersburg, Samara, Yaroslavl, Petrozavodsk, Novocherkassk of Rostov region, Cherepovets of Vologda region);
- III - cities which managed to achieve progress only in some lines of housing and communal reform (Kazan, Tobolsk of Tyumen region, Kansk of Krasnoyarsk region);
- IV - cities which are just going to initiate their own program of housing and communal reforming (Ulyanovsk, Magadan, Nalchik).

Review of the housing and utility sector reform in the cities found at different stages of this process made it possible to obtain the data on the variety of problems emerging in the course of reform such a complex sphere of production as utilities, as well as to employ the experience of one city in the day-to-day practice of others.

Several of the cities selected as pilot reform cities were really at the starting point of making these reforms, as documented by the information in Table 4.5. Hence, these were very labor intensive for the HSRP to achieve significant results during the year. The team worked with all of the these cities in the following areas:

- divestiture of enterprise housing to the municipality
- creation of competitive maintenance systems
- encouraging unit privatization
- creation of the legal foundation for formation of condominiums and encouraging residents to create condominium associations

Table 4.4
Cities Targeted for Assistance in 1997-1998

city	EHDP city	pilot city
1. Nizhni Novgorod		x
2. Novgorod		x
3. Yaroslavl		x*
4. Petrozavodsk	x	x
5. Cherepovets	x	x
6. Novoscherkassk		x
7. Tobolsk		x*
8. Kazan		x*
9. Ulyanovsk		x*

city	EHDP city	pilot city
10. Samara		x*
11. St. Petersburg		x
12. Nalchick		x*
13. Magadan		x*
14. Kansk		x*
15. Vladimir	x	
16. Ryazan	x	
17. Volhov	x	
18. Orenburg	x	

* City in which HSRP previously has not worked intensively.

Table 4.5
Summary Information on Pilot Cities
Which Are At the Early Stages of Reform (July 1997)

city	situation
Nalchik	-- rents not increased since 1995; Resolution N.707 not implemented -- housing allowances have not been implemented -- no competitions for selecting maintenance contractors -- no homeowners associations created -- housing divestiture is nearly completed
Kansk – Krasnoyarsk krai	-- rents increased in June 1997; first time since March 1996; tenant payments cover 40% of costs; Resolution N.707 not implemented -- large problem with payment arrears -- housing allowances operate, but with problems -- no competitions for selecting maintenance contractors -- 1 homeowners association created in 1993; normative base is absent
Tobolsk --Tymen Oblast	-- no increase in rents since 1995; Resolution N.707 not implemented -- housing allowance program operates -- no competitions for selecting maintenance contractors -- 7 homeowner associations exist, but the local legal base is inadequate -- enterprise housing divestiture is nearly complete
Kazan	-- cost coverage at 25%; Resolution N.707 actively being considered -- Republic has its own social safety net program involving "tokens" for rent and food purchase given to needy households; works inefficiently -- no competitions for selecting maintenance contractors -- no homeowner associations exist
Magadan	-- per square meter costs for housing and communal services are 52% above the federal

	standard for the region -- housing allowances operate, but with major problems -- no competitions for selecting maintenance contractors -- no homeowners associations created; normative base is absent -- city administration lacks even the basic normative documents concerning housing reform
Ulyanovsk	-- rents increased in June 1997; tenants now pay 15% of cost of services -- housing allowances operate, but with major problems -- no competitions for selecting maintenance contractors -- no homeowners associations created; normative base is absent -- attitude of administration toward reform is unenthusiastic

The HSRP team collaborated with the city administrations on the following:

- development by the city of its program of the communal sector reform;
- updating the communal sector management procedures;
- development of competitive maintenance of the housing sector;
- breaking the monopoly position of utilities;
- support in the formation of home owners associations;
- tariff-setting for utility services paid by residents;
- implementation of housing allowances programs; and
- strengthening the discipline of utility payments.

On January 20-21, 1998, the UI-IUE jointly with the RF Gosstroy and Novgorod city administration held a round-table discussion of the key problems of housing and communal reform with the 14 cities. First, the discussion identified problems common for all pilot cities; second, it demonstrated the increased understanding by all pilot cities of the procedures and process of sector reform.

Discussion was divided into sections; each addressed a certain group of problems: (a) demonopolization of the sector, (b) local natural monopolies regulation, (c) residents' coverage of housing and utility costs and housing allowances programs, (d) formation of homeowners associations.

The "round table" showed a significant progress in understanding of the aims of reform by administrations of the cities which began to reform the sector not long ago. Actually all participants in the discussion were unanimous in understanding of the reform tasks and ways on how to solve them. The main attention was paid to the experience of the cities that were most successful in this or that direction of the reform: Novgorod - in the sector demonopolization, St.Petersburg - in regulation of tariffs, Cherepovets - in residents' coverage of utility costs, Novocherkassk - in formation of homeowners associations. For all participants it was very important to share their opinions on how further to implement the reforms in the cities.

The "round table" managed to expose a problem common for all participants. The cities involved in the process of reforming the housing sector usually reduced the volume of the budget subsidies for the housing sector. In accordance with adopted 1998 city budgets, the RF subfederal authorities established lower norms for budgetary support for the cities. Such a situation does not encourage cities to cut budget expenses.

For the last year the cities produced no drastic changes in the sphere of housing and utility services. But

this was expected, since the aim of such restructuring is to provide stable and more efficient functioning of the sector. However, nearly all city-participants managed to produce some positive results.

This may be illustrated by examples stated below.

- In Novgorod activities updated housing sector management procedures and introduced competitive selection of contractors for housing maintenance with the result of cutting current operating costs by 52%.
- Competitive maintenance has become usual for nearly all pilot cities. Nizhny Novgorod and Novgorod took the lead in this sphere of reforming. There more than 50% of the municipal housing stock is maintained on competitive basis. It is the year's high for Russia.
- Since enactment of the RF Government Resolution #702 operating costs per 1 sq. m. of housing has been reduced by 4-15% in the cities of Tobolsk, Kazan, Saint-Petersburg, Novocherkassk, Yaroslavl.
- As for regulating and setting tariffs for natural monopolies, of special note is the experience of Saint-Petersburg municipality which initiated audits of the major utility suppliers in the city which revealed vast hidden reserves for reducing utility costs. According to the audit statement the city water supplier ("Vodocanal" enterprise) may lower cost of water by 38%.
- Expert review of heat and water tariffs in Tobolsk permitted the reduction in monthly cost of relevant services by 1300 rubles per 1 sq. m. The similar tariff review carried out in Yaroslavl also resulted in reduction of utility costs.
- One of the major tasks of the housing and communal sector reform is fostering the process of housing privatization and creation of home owners associations (HOA) employed as a tool for improvement of multifamily buildings management. The best results in this work were achieved by Saint-Petersburg (86 HOAs), Nizhny Novgorod (77 HOAs), Novocherkassk (42 HOAs), Novgorod (30 HOAs). Ulyanovsk (19 HOAs).
- According to the federal standards in 1997 the residents were to cover 35% of operating costs. These standards were outperformed by Novocherkassk (53%), Tobolsk (40%), Petrozavodsk (40%), Samara (40%), Kansk (40%), Nalchik (40%), Cherepovets (40%), Saint-Petersburg (40%), Novgorod (36.5%). Magadan, Kazan and Ulyanovsk have the lowest indices - 20%, 25% and 28% respectfully.

However, Ulyanovsk went through the most cardinal changes as far as the policy of residents' coverage of maintenance and utility services is concerned. While in April 1997 the city inhabitants covered only 7% of the services cost, in November 1997 this percentage was already 28%. Cost coverage in Nalchik also increased from 19% to 40%.

According to 1998 federal standard, during 1998 the share of tenants payment for housing and utility services cost should reach 50% of its cost. By July 1998 such indicators were reached in: Novocherkassk - 57,4%; Novogorod - 50%; Yaroslavl - 50%; Cherepovets - 50%; Orenburg - 50%.

- All pilot cities managed to establish Housing Allowances Offices responsible for providing targeted social support to low-income households. All pilot cities had prior experience on providing such assistance except Ulyanovsk and Nalchik which actually started this kind of activity only as pilot cities. As a result they have a very small percentage of households receiving allowances - 0.7% in Nalchik, and 0.9% in Ulyanovsk. But both cities are making rapid strides. Samara has the largest percentage of households receiving allowances - 28%; it is followed by Petersburg - 20%, Petrozavodsk - 19%, and Novocherkassk - 13%.
- The cities achieved good results in bill collecting process as far as residential consumers are concerned. Percentage of uncollected bills ranges from 4% to 12% of amounts billed for the 1998 reporting period.

By July of 1998 the results of individual cities differ greatly because of differences in the start-up period of the reform and long-term nature of the reform process. Table 4.6 provides basic data for all cities.

Table 4.6
Aggregate data on major indicators of housing sector reform in cities of Russian Federation
July of 1997

¹	Name of the city	Cost of housing utilities per one square meter (rbls/month)	Rate of compliance of operating cost with the federal standards ¹⁰	Coverage of cost of utilities %	Share of payments for operating costs in average household income ¹ , %	Housing allow-s, number of households/share of recipients	Overdue rent charges ² %	Share of enterprise housing ³ , %	Number of home-owners associa-s ⁴	Number of competi-tions/share of municipal housing maint-ed on competitive basis ⁵
		1	2	3	4	5	6	7	8	9
1	Novgorod	8404	0,98	36,5%	7%	3668/4,5%	10,3%	3,8%	15	3/3,5%
2	Tobolsk	10200	1,15	40%	5,6%	2346/7,1%	22%	5%	7	0/0
3	Petrozavodsk	7173,5	0,83	40%	5%	19000/19%	10,8%	10,5%	9	4/12,3%
4	N. Novgorod	6671	1,08	33%	5,8%	45270/9,2%	7,2%	55%	60	29/34,4%
5	Samara	7640	1,21	60%	11%	130266/28%	12%	32%	6	0/0
6	Kansk	7170	0,8	40%	10%	383/2,1%	8%	35%	1	0/0
7	Kazan	6430	1,02	40 % (with naim)	8%	nda/9,5%	8,4%	14,7%	0	0/0
8	Magadan	25638	1,52	20%	7,1%	654/2,6%	13,1%	8,7%	1	0/0
9	Nalchik	5321	0,84	19%	6,5%	0/0	4%	10,8%	0	0/0
10	Novocherkask	6448,3	1,02	50%	10,7%	8600/11,5%	13%	31,6%	28	9/8,3%
11	St.Peterburg	9700	1,13	40%	7,4%	29000/20%	11%	nda	65	1/0.01%
12	Ulyanovsk	6932	1,1	14%	3,8%	419/0,2%	19,8%	30%	0	0/0
13	Yroslavl	7612	1,25	30,7%	10,1%	9321/4,2%	4,6%	42,3%	13	0/0
14	Cherepovets	5464,5	0,64	40%	6,2%	2128/1,7%	12%	4%	12	4/0
15	Ryazan	5950	0,98	20%	3,9%	1972/1,2%	8,7%	10%	49	12/16,1%
16	Vladimir	9996	1,64	21,6%	7,7%	1321/1,1%	nda	2%	11	11/6,4%
17	Orenburg	7502	0,83	37%	10,4%	14497/9,7%	8,6%	5%	24	4/11%
18	Volhov	nda	nda	36%	nda	411/3%	9,3%	0	3	3/7,3%

July of 1998

¹	Name of the city	Cost of housing utilities per one square meter (rbls/month)	Rate of compliance of operating cost with the federal standards ¹⁰	Coverage of cost of utilities %	Share of payments for operating costs in average household income ¹ , %	Housing allow-s, number of households/share of recipients	Overdue rent charges ² %	Share of enterprise housing ³ , %	Number of home-owners associa-s ⁴	Number of competi-tions/share of municipal housing maint-ed on competitive basis ⁵
		1	2	3	4	5	6	7	8	9
1	Novgorod	8,14	0,86	36,9%	5%	3358/4,1%	15,7%	3,8%	30	9/40,5%
2	Tobolsk	11	1,02	36%	10,5%	1751/5,3%	19,8%	5%	8	0/0
3	Petrozavodsk	5,94	0,63	40%	4,46%	12400/12,4%	10,3%	5,8%	20	6/18,5%
4	N. Novgorod	7,35	0,78	29%	5,3%	46949/9,6%	15%	40%	79	37/44,7%
5	Samara	7,69	1,08	40%	13%	65540/14%	13%	21%	8	16/2,2%
6	Kansk	7,2	0,67	40%	10%	1648/8,1%	9%	27,3%	2	1/2,2%
7	Kazan	5,4	0,76	40%	8%	34280/9,5%	8,4%	14,7%	12	0/0
8	Magadan	22,18	0,89	35%	11,6%	2059/6%	22,5%	8,7%	3	0/0
9	Nalchik	5,3	0,76	40%	13,2%	298/0,7%	17,5%	10,5%	0	0/0
10	Novocherkask	5,78	0,83	59,1%	14,5%	10000/14,8%	30%	31,6%	42	7/9,7%
11	St.Peterburg	8,2	0,87	40%	6,81%	316987/18%	14,5%	9,8%	76	13/2%
12	Ulyanovsk	7,5	1,05	28%	6%	3214/1,4%	13%	30%	19	0/0
13	Yroslavl	6,56	0,89	40,7%	10%	9833/4,8%	16,8%	2%	19	0/0
14	Cherepovets	7,66	0,81	50%	7%	2461/2,2% %	12%	1%	12	6/14%
15	Ryazan	5,73	0,77	40%	5,3%	6407/4%	16,1%	10%	55	17/28%
16	Vladimir	8,62	1,16	28,1%	8,2%	661/0,6%	13,1%	2%	13	11/6,4%
17	Orenburg	8,80	0,81	50%	12,7%	nda	nda	0%	31	nda
18	Volhov	nda	nda	42,7%	nda	352/2%	10%	0%	3	4/28%

1. It is computed as cost of housing utilities per one square meter multiplied by 18 sq.m and by the coverage of cost of utilities, divided by mean per capita income during the last month for which data is available, i.e.
 $E = (A * 18 * D / 100) / Y$, where Y is mean per capita income (in rubles/per month per capita).
2. Households who reside in municipal housing and who have overdue payments for housing utilities. It is calculated as a difference between computed and actually collected payments divided by computed amounts (over the first six months of 1997).
3. Share of enterprise housing is the ratio of total enterprise housing space to aggregate enterprise and municipal housing stock.
4. Number of registered home-owners associations in the city.
5. By the number of competitions we mean number of residential housing lots offered for competitive maintenance by a contractor company with which individual contracts are signed as a result of competition.
6. Subsidies to housing sector per capita over the first six months of 1997.
7. Share of enterprise housing is the ration of total enterprise housing space to aggregate enterprise and municipal housing stock.
8. Number of registered home-owners asociations in the city.
9. By the number of competitions we mean number of residential housing lots offered for competitive maintenance by a contractor company with which individual contracts are signed as a result of competition.
10. The standard is the average cost of providing housing and communal services per square meters in each economic region. A value grates them 1.0 indicates inefficiencing; values less than one indicate relative efficiency.

Moscow housing management pilot project. The staff has been working with Prefectures in Moscow to initiate the selection of management company through competitions to manage municipal housing. The project has worked with the Southeast Administrative District and the municipal-level housing office in Moscow for two years to launch the first competition to select a firm to manage municipal housing. No other city in Russia has implemented competitions for maintenance to the extent that Moscow has, and so at present Moscow is the unique city where tenders for housing management are realistic. The first competition was actually held twice, with the first result voided. The second was completed in early summer 1998 and a private firm selected as the winner.¹³ The firm was to take over responsibility for the 30,000 units involved in July 1998, when the contract with the DEZ expired. Further blocking action by the Municipal Property Committee blocked this. But start up is expected momentarily.

The competitively selected management company is to perform all functions of a Customer Office except: passport control and registration, civil defense actions, maintenance of civil defense facilities, delivery of summons and making lists of residents for city-wide purposes. These functions are to be performed, as usual, by a District Management ("Uprava").

The team also induced another region of Moscow - the Northwest (Mitino) - to undertake a similar pilot project in February 1997. Again, the winner has been delayed in beginning management but is anticipated to start soon. Among cities outside of Moscow, Nizhni Novgorod made the most progress on implementing maintenance competitions. Importantly the municipality of Nizhny Novgorod sent observers to participate in the management competition held in the Southeast Administrative District in Moscow.

The staff was deeply involved in the development of the program for introducing competitiveness in the sphere of housing management, which implied devising the technique of contracts bidding, preparation of a model property management contract, and rendering technical assistance to municipal bodies in on-stage performance of competitive selection of contractors for residential property management. A study tour to the U.S. was organized for the contractor and for municipal officials to observe how very large holdings of residential property are managed and how the owner monitors the performance of his management contractor.

Institutionalization

1996-1997. The emphases for institutionalization in 1996-1997 were three-fold:

- 1) Establishing Regional Centers and joining in partnerships with training organizations in those localities. These centers were the focus of UI activity and helped to maximize the effective use of its resources. They were where UI staff and consultants worked with the municipalities of a given region to establish reform programs and institutionalize them on a broad, nation-wide scale.
- 2) Continued development of the capabilities and expertise of IUE. This organization continued to implement new programs and to work closely with UI to further the goals established under HSRP I and II.
- 3) Continued work with cities that voiced interest in furthering housing reforms in their areas

¹³ In fact, two previous competitions were held in 1996 and 1997 but resistance by the City Property Committee and others prevented a contract being signed.

through Moscow-based consultations.

Products. The project had an aggressive dissemination program. The UI team developed many of the written products and other support materials necessary to inform cities and condominiums about housing reform issues during Year One of HSRP II. Therefore it spent much less time and energy in Year Two on such issues. Instead, the Institute directed its resources towards the goal of broad dissemination of information through consultations and training programs held in the Regional Centers. Products included:

- Development of new brochures on the Russian Federation Condominium Law. (“Associations of homeowners - your choice” - T.Kutakova; “Questions and Answers about homeowner associations”; “Preparation of Public Offering Statement for a condominium under construction” - T.Kutakova; “Recommendations on accounting and book-keeping in homeowner associations” - A.Schegolev).
- Articles and graphics to assist local officials inform residents in the process of formation and management of condominiums (“Urban Institute professionals answer the questions about condominiums”, article in newspaper “Kvartirier” #5-9, March-May, 1996; “Condominiums in Ryazan risen on the easy legal ground” - M.Roumiantseva, S.Sivaev, article in newspaper “Kvartirier” #6, March, 1996; “Condominium - what’s behind the name?” article in newspaper “Priokskaya gaseta”, July, 6, 1996; “Legal base of creation and activity of condominium associations” (chapter 1); Foundation of Condominium Associations (chapter 2); Condominium Associations Activity (chapter 3)” - O.Gorodov, 3 articles in brochure published by St.Pete City Economy Management Committee “Legal and practical recommendations on creation and activity of condominiums associations in St.Pete”, November, 1996)
- A brochure discussing the issues and tasks involved in creation of customer service entities at the municipal level. (“De-monopolizing Housing Stock Mangement and Maintenance” - M.Pinegina, D.Khomchenko, O.Kim, S.Sivaev, E.Petrova, M.Shapiro)
- Brochures on the issues and problems involved in conducting fair maintenance competitions. (“How to Organize the Competition on Maintenance of Housing Stock. Moscow Case Study” - M.Shapiro, E.Petrova; “How to Provide Efficient Maintenance of Municipal Housing” - R.Struyk, M.Pinegina, M.Shapiro)

HSRP II made these materials available to municipalities that request them and through the Regional Centers.

1997-1998. The IUE staff has been effective in institutionalizing the reforms and techniques developed under HSRP. In the process, they have developed skills in the areas of legislative development, marketing and outreach, training, and materials development. Increasingly, they are the authoritative source to which outlying cities turn for advice in the process of housing reform. This is evidenced by the fact that IUE staff were often featured speakers at seminars regarding housing reform issues throughout the country and by the contracts being concluded by IUE with local governments which cannot be assisted under the USAID program.

Products. The HSRP team developed many of the written products and other support materials necessary to inform cities and condominiums about housing reform issues during the past several years. Despite this fact, a constant flow of new material was necessary to promote the successive waves of reform. The following materials were developed:

- Brochures discussing the issues and problems of fair maintenance competitions; contractual

relations of homeowner associations, implementation of the concept of housing reform in the RF and transfer to the new system of rent payments (Methodical materials on implementation of the concept of housing communal sector reform in the RF (recommendations for drafters of regional programs); Transfers to the new system of housing payments and introduction of housing allowances in the Russian Federation; Payment for housing and utilities in the RF in October 1996-March 1997; Payment for housing and utilities in the RF in March-September 1997; Homeowners' Associations contractual relations "Associations of Homeowners" issue 4; Competitive housing maintenance: Questions and Answers. "Housing maintenance and management". Issue 3; Agreement of technical maintenance, sanitary upkeep and current repairs of housing stock and adjacent territories with comments. "Housing maintenance and management". Issue 4)

- Articles and graphics to assist local officials to inform residents about the process of housing reform (Condominiums: Challenges and Perspectives - "Nalogoplatelshik" newspaper, February 1997; Condominiums in Russia - "Your right" magazine, March 1997; Table of results of implementing the housing allowances program in the cities of Russia in 1996 - "Business in Russia" (supplement to "Rossiyskaya Gazeta), March 11, 1997; Housing rent being risen - what's next? - "Real estate of St. Petersburg" newspaper, April 14, 1997; House - to the ownership of residents - "Your right" newspaper, June 12, 1997; "At hotel" price - "Your right" newspaper, June, 1997; Article on housing payments - "Business World", September 26-29, 1997; Papers for round table discussion on acute issues of housing reform hold by the institute for economic forecast of the Russian academy of sciences - "forecast problems" #6, 1997; On competitive basis, Magazine "For stock-holders", September, 1997; Comments to the RF law "On Associations of homeowners" - "Housing and Communal Economy" magazine, April #4, 1998; Better to spend less than to pay more - bulletin of the Russian Information Agency "News" - "Panorama", June, 1998).

The IUE team also participated in development of legal documents (see Chapter 3) and conducted seminars on implementation of housing reform in Russia (see Annex C):

Summary

The project was successful in working with Russian officials in constructing the necessary legislative base and in launching the implementation of fundamental reform. While it is difficult to assess the true impact of the Urban Institute's work in the target cities, some general conclusions can be drawn from UI activities during the period from October 1, 1995 to October 1, 1998.

Competitive maintenance programs are progressing reasonably well in most cities with the assistance of HSRP project staff. Moscow continues to lead the way with its fairly aggressive program. All other target cities (except Petrozavodsk) have just completed or are in the process of organizing new competitions. The cities are also carefully scrutinizing the structure of their Customer Service entities, where necessary, or planning for the introduction of such organizations.

As many cities reach levels of almost 90% divestiture or more, acceptance of divested stocks has slowed as the remaining stock still on the balance of enterprises tends to be composed of housing in very poor condition. It is also proving very difficult to divest some housing due to various legal or administrative problems (housing stock on the balance of the railroad, for example). Some cities (Moscow, Novocherkassk) state flatly that they have no plans to accept any divested housing in the remaining months of 1998 Others have plans to continue accepting divested stocks, but only if the

funding for its repair and maintenance can be secured. Because progress depends almost entirely on the cities' economic situation and the political will of the city leaders, there appears little that Institute staff can do in the short term to speed up the process of divestiture in the target cities.

Progress on increasing the percentage of costs of maintenance and utilities recovered from residents has stagnated. In part this results from the large real increases in tenant payments required just to maintain cost recovery levels in 1995 as energy prices were significantly decontrolled in Russia. In part, it is also due to cities' perception that until economic conditions improve for residents, increased cost recovery will remain a difficult goal to pursue. It is also extremely volatile politically, as can be witnessed by city leaders refusing to raise tariff rates during the summer and fall election campaigns.

All the cities have implemented housing allowance programs. Although application requirements vary city to city, housing allowance programs have proven successful and effective in all the target cities. The importance of the Institute's activities lies primarily in helping city administrations fine-tune their programs. Also, participation rates remain well below the 25% level set by the World Bank as an upper limit of a combined efficient rent increase - housing allowances program. Thus, the cities may be able to raise cost recovery percentages further in an attempt to meet the targets set by the World Bank and then assist additional residents through the allowance program.

Privatization of units has slowed significantly over the past four years. It appears that the advertising programs initiated by the Institute have had little impact on interest in and actual rates of privatization of apartments.

HSRP has been instrumental in helping the cities formulate policies and procedures for the creation and registration of condominiums. With the exception of Petrozavodsk, the process continues well in all cities. The cities have been struggling with the questions of subsidy funds they should pay to condominiums in new buildings, the percentage of privatized units necessary before a condominium can be formed in a building, land allocation issues, and distribution of income from commercial spaces. An extremely important factor in this regard was passage in 1996 of the Russian Federation Law on Home Owners Associations (Condominiums). The Law clarifies many of the issues regarding condominium formation and finance so that cities now have a consistent basis on which to model local regulations. Before the enactment of the Law, regulations tended to differ significantly from city to city. As these issues are worked out in coordination with the new Law, the growth in the number of condominiums can be expected to continue to increase.

5. Housing Finance

HSRP II labored to increase commercial bank lending for long-term mortgages (1995-1997) and construction period finance (1995-1997). In addition, it attempted over the same period to organize loans to condominiums for rehabilitation without success. The issue here being the lack of credible collateral which homeowner associations could pledge.

This chapter first discusses mortgage lending and then construction period finance. A final section outlines the project's work in training bank staff. Chapter 6 presents the project's work with the Agency for Mortgage Lending.

Mortgage Finance

Although the inflationary environment has begun to reach a level of stabilization, high interest rates and the lack of clear legislation continue to be deterrents to expanded mortgage lending activity by Russian banks. The lack of long-term resources, high reserve requirements by the Central Bank, and the high returns offered from low-risk government securities also reduce incentive for this kind of lending. While still profitable, mortgage lending is viewed as a less attractive investment when compared with lower risk state securities. Strained liquidity and the general instability within the banking sector have kept interest rates higher than expected.

Despite these factors, more and more banks have been entering the mortgage lending market for the first time. This trend can be attributed to a greater awareness of mortgage lending through our work in HSRP I and HSRP II and an overall industry trend away from speculative trading on the interbank market. Ironically, the relative instability of the banking sector may ultimately have a positive effect as banks search for new methods to diversify their business to remain competitive. More banks have identified the need to balance their investment portfolios in stable, yet less profitable investments. While the vast majority of Russian banks continue to concentrate their business in wholesale banking rather than retail and consumer lending, mortgage lending has proven to be a valid means for opening the door to a more stable banking system.

With HSRP assistance, commercial banks have implemented viable mortgage lending programs which can work effectively under the current environment. Loan originations have risen to over 4,000 mortgage loans since introduction of the program, with continued growth likely. As the returns on government bonds decrease, we expect increased activity in mortgage lending. In any case, Russian banks view mortgage lending as necessary for future growth, with most choosing to take a delayed or limited role at this time.

These factors point to the conclusion that mortgage lending has not yet reached its full potential. The project's purpose has been to introduce the mortgage lending program, however limited in scope, in order to create conditions for future expansion as economic conditions improve. Banks that have taken this initial step have positioned themselves to capture this emerging market. As the market becomes more established, these banks will have the necessary infrastructure established and a trained staff to compete and expand.

HSRP work has shown that outdated banking practices have been a stumbling block towards greater expansion of mortgage lending (and consumer lending in general). Updating amortization

procedures to industry standards have proven that banks can lower the loan payments for their clients, making the loans more affordable and widening the potential mortgage lending market. The introduction of self-amortization has also had a positive effect by increasing profitability on the mortgage lending investment. By looking at a mortgage loan as an investment, banks have begun to understand that this type of lending is both profitable and stable.

The introduction of new loan products, developed specifically for the Russian economic and legislative environment, have proven to be extremely popular with Russian banks. The Bridge Loan, introduced in HSRP II, has been adopted by nine Russian banks with an estimated volume of 760 loans originated to date. The Bridge Loan is being used as a means for new banks to break into the mortgage lending market. By tapping into the existing equity of privatized units, a borrower can afford to "trade-up" to an improved unit. Using a Bridge Loan/mortgage loan program, Russian banks can offer both an affordable and lower risk loan to their clients. The Home Improvement Loan, also introduced in HSRP II, has opened the door towards a greater emphasis in the area of consumer lending. Banks offering the program have stepped-up marketing of the program through their affiliate network and are making progress in developing this potentially lucrative market.

Activities During the Period. The program made a dramatic turn in its activities from HSRP I to HSRP II. Leadership of the housing finance program shifted to a highly qualified Russian. While the focus of the program remained the same, emphasis was placed on establishing the Institute for Urban Economics as the primary source of future training and consulting. The activity of the project on mortgage lending was scaled back considerably. The pilot phase had produced a base of more than thirty Russian banks, geographically diversified, which have or are scheduled to begin mortgage lending programs. These banks were used as the base for consultations from the Institute for Urban Economics.

Banks in the program which received technical assistance under HSRP II were encouraged to continue their current relationship, but on a fee basis. The Institute for Urban Economics became a leading institution for housing finance information, research, and innovation. Banks are asked to pay consultancy fees for work performed by staff consultants trained under HSRP I and HSRP II. Fees are also be charged for direct consultations with bank staff, training to the bank's affiliates, and speaker's fees. An overall fee schedule was developed to encompass staff consultations, training, and computer software.

The focus on banks which have received previous technical assistance turned towards more advanced assistance in the financial analysis, advanced business planning, risk management, and strategic planning. HSRP continued its relationship with banks already in the program, but through the Institute for Urban Economics and under a fee-basis arrangement.

The program concentrated its free-of-charge technical assistance on banks in "priority cities" (1995-1996) and in the new regional centers (1996-1997) and on training through the Institute for Urban Economics (generally on a fee basis). Banks were targeted for work in mortgage lending in each of the regional centers, assuming these are cities where banks have not been previously assisted. Technical assistance to new banks within the regional centers continued to be without charge.

In 1995-1997 work was continued on formation and development of the system of long-term housing mortgage lending in Russia. Studies on different aspects of mortgage lending by the banks considering specific features of legislation and consumer loans in Russia were carried out.

Thirty banks in different cities of Russia: Moscow, Yekaterinburg, Nizhny Novgorod, St. Petersburg, Irkutsk, Novgorod, Cherepovets, Ryazan, etc. were involved in the activity. The number of banks with a strong interest in mortgage included both large banks determining bank policy in this country (Bank “SBS-AGRO”, Sberbank, “Menatep”, Mosbusinessbank, “Neftyanoy”, Bank “St. Petersburg”, etc.), and relatively small banks interested in attracting natural persons (Diamant, Novobank, Sokolbank, Ipotekobank, Mortgage Standartbank, Vostssibkombank, Mortgage Stock Bank to name just a few)(Table 5.1)

Table 5.1
Bank-clients of HSRP for Residential Mortgage Lending in 1995 - 1997

City	Bank
Moscow	<ol style="list-style-type: none"> 1. "SBS-AGRO" 2. Diamant Bank 3. Inkombank 4. Menatep Bank 5. Mosbusinessbank 6. Most-bank 7. United Industrial Bank 8. Ogni of Moscow Bank 9. Moscow Branch of the Sberbank of Russia 10. Sberbank of Russia 11. Vostok-Zapad Bank 12. Belkombank 13. Mortgage Joint-stock Bank 14. Mortgage Standartbank
Yekaterinburg	<ol style="list-style-type: none"> 1. Uralsky Commercial Industrial Bank 2. Uralpromstroybank 3. Sverdlotsbank 4. SKB-bank
Irkutsk	Vostochno-Sibirsky Commercial Bank
Ryazan	<ol style="list-style-type: none"> 1. Bank Serg. Zhivago 2. Priovneshtorgbank
Saint-Petersburg	<ol style="list-style-type: none"> 1. Baltiysky Bank 2. Petrovsky Bank 3. Promstroybank 4. Saint-Petersburg Bank 5. Mortgage Bank
Vologda (St. Petersburg Center)	<ol style="list-style-type: none"> 1. Marsbank 2. Skombank
Cherepovets	Sokolbank
Nizhniy Novgorod	<ol style="list-style-type: none"> 1. NBD Bank 2. Zemelny Bank

City	Bank
Vladivostok	3. Inkombank branch 1. Dalnevostichny Bank 2. Dalribbank 3. Primorye Bank
Rostov-on Don	1. Donkhlebbank 2. Donkombank 3. Rostovsotsbank 4. Centrinvest Bank

In 1995-1996 most attention was devoted to banks in the four HSRP priority cities--Moscow, Ryazan, Nizhny Novgorod, and Yekaterinburg (which replaced Vladimir because of low bank interest there).

According with the workplan in 1996 work was begun with banks of the four new regional centers: Far East, South Siberia, and Far North of the Russian Federation. Consultations on the problems of housing mortgage lending were held in banks of Vladivostok, Rostov-on-Don, Irkutsk, Vologda (Far North). The banks are listed in Table 5.2. Note these are in addition to other banks in the regions with whom the project already worked.

Table 5.2
Banks in Regional Centers with Which
HSRP Worked in 1996 - 1997

<i>City</i>	<i>Bank</i>	<i>Active / Not active in RML in summer 1998</i>
Vladivostok	1. Dalnevostichny Bank 2. Dalribbank 3. Primorye Bank	NA NA A
Rostov-on Don	1. Donkhlebbank 2. Donkombank 3. Rostovsotcbank 4. Centrinvest Bank	A NA NA A
Vologda (St. Petersburg Center)	1. Marsbank 2. Skombank	NA NA
Irkutsk	Vostochnosibirsky Commercial Bank	NA

The main lines of the program were:

- Consulting services to the banks;

- Short-term seminars on different aspects of mortgage lending;
- Bank staff training within the program “Certified Mortgage Lender”;
- Preparation and publication of booklets and articles on problems of mortgage lending;
- Preparation of analytical messages, reports and monitoring of mortgage lending market development.

Consulting services to the banks. Consulting was done on establishment and development of mortgage activity in a bank. The Fund experts were constantly studying and generalizing the experience in Russia and abroad. Development of housing mortgage lending in Russian banks was under constant monitoring. This served as a foundation for improvement and in-depth studies of materials, methods and guidelines developed by the Fund and recommended for use by the banks. Cooperation with banks included the following components:

- developing recommendations on establishing organizational structure in a mortgage bank or mortgage department in a bank;
- methodical assistance in loan underwriting and origination; elaboration and provision of documents and guidelines regulating these processes;
- peculiarities and organization of mortgage loans servicing;
- software provision of the bank mortgage activity: software installation for analysis of cash flows in mortgage lending with the use of targeted housing savings deposits; processing mortgage loan applications and preliminary qualification of the borrower; comparative analysis of mortgage lending instruments;
- elaboration and presentation of packages of civil-legal agreements on mortgage lending, consulting services on how to use them;
- mortgage lending marketing, submission of information on existing mechanisms of mortgage lending; summing-up of Russian and foreign experience in mortgage lending;
- elaboration of business-plan for mortgage lending activities in a bank.

The work with the banks resulted in their interest in mortgage lending and their attempts to start mortgage projects in their cities.

In Rostov-on-Don the Donkhiebbank and the "Tzentrinvest" bank made practical use of a number of IISRP group recommendations on conducting mortgage operations. The Donkhiebbank worked on a limited scale on the housing loans market. It used various schemes of lending: lease with the right to purchase, traditional mortgage, combination of pledge and suretyship. Loans were made for the term of 1 to 3 years with an average interest of up to 60-90 annual percent (in rubles). The "Tzentrinvest" mostly used a combination of pledge and suretyship by the organizations that were clients of the bank to secure its loans. Taking into account recommendations of the group experts, the bank issued to its clients loans for housing purchase, bridge loans, loans for housing improvement for the period of 3 months to 3 years.

In Vladivostok, the "Primorye" bank originated 10 loans for housing purchase against the purchased housing on condition that no one is to be registered at the premises. The loans were made for the term of 3 months with a further prolongation to 1 year at 80 annual percent in rubles.

In Irkutsk Vostoksibcombank realized a traditional mortgage lending scheme by making loans against mortgage of purchased housing.

In Vologda Marsbank and Skombank originated several bridge loans for housing conditions improvement as well as several loans for purchase of apartments secured by suretyship of organizations - clients of the banks.

In general mortgage loans origination in these regions was of a limited character due to a number of circumstances:

- weak resource base for long term lending;
- low paying capacity of citizens;
- fairly high prices for housing;
- high cost of resources for banks and correspondingly high interest rates on the loans;
- lack of an adequate legislative framework.

Conducting short-term seminars on different aspects of mortgage lending. In the course of seminars the following items pertaining to the problems and prospects of mortgage lending in Russia were brought up:

- federal targeted program “Your Own Home” and the prospects of housing mortgage development in Russia;
- legal aspects of mortgage lending;
- basic stages of the mortgage lending process;
- financial provision for mortgage loans;
- software provision of mortgage lending (cash flow analysis in mortgage lending, processing mortgage loan applications, loan servicing);
- basic risks of mortgage lending;
- mortgage lending instruments;
- different types of mortgage products;
- experience of Russian banks in mortgage lending.

Table 5.3
Mortgage Lending Seminars Held for HSRP Regional Centers’ Banks in 1996-1997

<i>City</i>	<i>Date</i>	<i>Number of participants</i>
Rostov-on-Don	October, 96	65
Vladivostok	November, 96	56
Irkutsk	April, 97	47

Status of Banking Lending in HSRP Target Cities. Consultations by the Fund experts urged banks to promote mortgage lending in day-to-day banking. In 1995 services of this kind were offered in Moscow alone by several dozens of banks. Mortgage Standartbank (Moscow) was one of the first to grant long-term home purchase mortgage loans to workers of large enterprises (KAMAZ, tobacco factory “Yava”). The largest Russian banks-Menatep, Mosbusinessbank-granted housing loans to their staff. Most banks used this kind of lending as an incentive. It also gave an opportunity to practically use this kind of lending without particular risk.

The “Neftyanoy” bank was one of the first to start granting loans to population. The model of

lending designed by the bank in collaboration with “Krasnye Vorota” realty was later on widely used by a score of lending establishments. The bank gave out about 200-250 home purchase loans. But the bank “SBS-AGRO” was the most active on the market of long-term housing lending. In 1995-97 the bank made more than 1,700 loans to the amount of more than 60 mln. US\$, with the average loan size of 40,000-50,000 US\$.

The widespread of mortgage lending was blocked by loan risk; therefore only a small amount of banks made actual mortgage loans, striking with the borrower a loan agreement plus mortgage agreement securing the former. (Among these banks are “SBS-AGRO”, Diamant, Dialogue-bank (with additional guarantees from legal entities employing the borrower), Investsberbank, Mosbusinessbank (for its staff mostly), Vostsibkombank, Fora Bank, etc.)

However the most widespread was the model of “home selling on installment plan” based on a lease agreement with the borrower for the housing that was to be obtained with the loan funds with the right to buy it out (lease-purchase agreement). This model was the core of lending activity at “SBS-AGRO”, which worked in collaboration with the Universal Financial Company, a number of realty firms like “Housing Initiative”, SAVVA, “BANSO” and other. So in 1995 Stolichny Bank of Savings in cooperation with the Universal Financial Company offered its clients loans tied to US dollar for the term of 10 years; in this case the interest was lower than that on short-term loans. For instance, when the loan term was 3 months the interest charged equaled 27.5 annual percent, and respectively 25 per cent for 2 years and 19.5 per cent for 10 years. The reaction was however unexpected: clients preferred to take short-term loans for 1-2 years mostly due to unstable position of commercial enterprises and lack of trust in them on the part of the clients.

When this approach was used the procedure of loan acquisition was rather expensive for the borrower. Considering the payment on bank services to the amount of 4 per cent of the apartment price and 1.5 per cent for real estate insurance (with the loan term of 3 and more years), the client had to pay 14-17 per cent of the price for the housing purchased only for the deal made, whereupon in the case of default on the loan these funds were not returned.

The most complicated task the banks faced was the need to protect yield on lending deals from grave interest rate risk (which is to a large extent caused by a short-term nature of the bank obligations and a long-term nature of mortgage loans). On the other hand, the banks had to simultaneously make the loans affordable for the borrower.

The banks involved in mortgage lending tried to master interest risk through using various loan instruments. Thus, Sberbank made mortgage loans with a variable rate set on the same level with the rate of discount in the Central Bank; and the Nizhegorodsky lending bank, and Yaroslavsky branch of Mortgage Stock Bank used an instrument under which the indexing of the principal debt amount was done proceeding from the officially set level of the minimum wages.

More widely adopted were loans made in US dollars, when formally all the loan conditions and payments were defined on the basis of currency indicator with a fixed rate, and the borrower made regular payments in rubles at the current dollar exchange rate. This financial instrument was used by the banks “SBS-AGRO”, Alfa bank, “Neftyanoy”, Menatep, etc.

Mosbusinessbank made loans using a financial deferred adjustable instrument (DAIR), that was elaborated for Russian conditions of highly inflational economy by the experts of the Urban Institute. In accordance with this approach two interest rates and an index tied to the cost of bank funds were used, which helped the lender to fully or mostly shift the risk of interest rate to the

borrower. The DAIR simultaneously used 2 interest rates: a payment rate - the rate defining the amount of monthly payments by the borrower (usually 5-10 per cent) and contract rate defining the actual debt amount on interest. When DAIR was used the contract rate was based upon the interbank lending rate plus additional charges for compensation of administrative expenses, ensurance of profit. The difference between the amount of debt and the amount that was paid off was capitalized on a monthly basis and increased the balance of principal debt amount. In inflation period the use of indexed instruments helped lower the primary interest rate on the loan to 5-10 per cent, make it more affordable to the borrower and ensure necessary profitability for the bank.

Later on the bank started making loans with a variable interest rate. This was caused by changes in economic situation within the country (lowering of inflation), as well as the desire for a more comprehensible interest payment scheme.

Banks addressed differently the problem of attracting funds to finance long-term housing loans. Their considerable interest was aroused by housing savings programs.

The Moscow Mortgage Stock Bank (MSB) was one of the first to practice housing saving programs with its clients. MSB opened targeted family housing savings accounts (further- family accounts) for its shareholders. This project was worked out in cooperation with experts from the Urban Institute and was viewed as the first step to mortgage lending by the bank. On the whole the accounts were opened by citizens of average income. The typical amount of savings recorded in applications for opening a family account was about \$ 5-6 thousand. The basic targets of savings were a one-room apartment in Moscow and Moscow region, a house or a dacha. Average term of saving - about two years.

An interesting scheme of housing savings was promoted by the Stock Commercial Mortgage Bank “Sokolbank” (the town of Cherepovets) together with the Center for Mortgage Business which it had created. Their program of housing savings was built to address construction and mortgage lending. First, the bank enrolled those willing to acquire housing through share participation in construction (usually completion) of a certain building, and made an agreement with contractors for phased construction works in fixed time and in line with set cost estimates.

Then the scheme was carried out in the following way. During the whole construction period (which lasted for about a year) shareholders of the bank made monthly payments, calculated on the basis of construction cost estimates in such an amount that half of the new apartment price was paid off by the end of construction works. To pay off the amount left the client took a one-year-loan from a bank with annual 50 per cent interest on it (October 1995 rate) against mortgage of the newly constructed apartment. These are the general conditions of the scheme, but in practice its various versions were used.

The “Housing Initiative” corporation together with a number of banks, SBS-AGRO in particular, offered citizens willing to purchase housing a “Kombiinvest” savings program with the provision that the client placed his money at low interest with the purpose of further guaranteed acquisition of a relatively cheap loan and an apartment. In this scheme the bank took the responsibility of accumulating the assets of its depositors, calculating interest, guaranteeing the return of money and payment of interest on it, and lending. The corporation carried out the housing construction project and guaranteed the depositor an apartment in it.

The Sberbank of Russia worked out Regulations “On housing savings contracts” and “On grace housing mortgage loans”. Housing savings contracts included conditions and procedure of

accumulating funds used for housing purposes; it also defined the main clauses of making a favorable mortgage loan. The term of contract was to be no less than a year. The bank set minimum deposit amounts of the housing savings accounts, and the depositor had to replenish his deposit at least quarterly. Underlying the deposit interest was the basic interest rate for one-year-contracts determined by the bank's Board of Directors.

As the term of the savings contract expired, the depositor had a right to receive a grace mortgage loan (on condition that all the clauses of the contract were realized). According to the effective conditions, the amount of favorable mortgage loan could not exceed the funds saved on the housing account during the term of housing savings contract. Simultaneously there were additional restrictions: the amount of obligations on the loan could not exceed 70 per cent of the appraised value of the mortgaged property, and payments on the loan and interest should be no less than 30 per cent of the borrower's income.

Table 5.4 summarizes mortgage lending practices in 1996 for a sample of banks with whom the project worked.

Table5. 4
Sample Survey of Banks on Housing Mortgage Lending in 1996

<i>Bank</i>	<i>Loan instrument</i>	<i>Term and LTV</i>	<i>Type of contract</i>	<i>Number of loans in 1996</i>
1.Mosbusinessbank <i>Moscow</i>	D,30 per cent	15 years 70 per cent	M	53
2.Vostsibkombank <i>Irkutsk</i>	R,20-113 per cent	3 years 60 per cent	M,L,E	53
3.Zemelny Bank <i>Nizhny Novgorod</i>	D,30 per cent	3 years 70 per cent	L,E	19
4. Mortgage Bank <i>St. Petersburg</i>	D,20-30 per cent	10 years 70 per cent	M,E	11
5. Stolichny Bank <i>Moscow</i>	D,25-30 per cent	10 years 70 per cent	M,L,E	720
6. Promstroybank <i>St. Petersburg</i>	R,120 per cent	5 years 70 per cent	L	5
7. Novobank <i>Novgorod</i>	R,10 per cent	2-5 years 70 per cent	E	46
8. Neftyanoy Bank <i>Moscow</i>	D,30-32 per cent R, 55 per cent	1-3 years 70 per cent	E	27
9. Bank Serg. Zhivago <i>Ryazan</i>	R,10-150 per cent	from 2 weeks and more than a year	E	133
10. Baltiysky Bank <i>St. Petersburg</i>	D,30-35 per cent	1-1.5 years 70-75 per cent	L	75
11. Inkombank branch <i>Nizhny Novgorod</i>	D,36 per cent	1 year 70 per cent^	L	65
12. Uralpromstroy-bank <i>Yekaterinburg</i>	R,120 per cent	up to 10 years	M,E	277
13. Menatep <i>Moscow</i>	D,30 per cent	1 year 70 per cent	L,M	50

<i>Bank</i>	<i>Loan instrument</i>	<i>Term and LTV</i>	<i>Type of contract</i>	<i>Number of loans in 1996</i>
14. Diamant Bank <i>Moscow</i>	D, 30-32 per cent	3 years	L	30
15. NBD Bank <i>Nizhny Novgorod</i>	D, 35 per cent	1 year 70 per cent	L	29
16. Inkombank branch <i>St. Petersburg</i>	D, 40 per cent	2 years 70 per cent	L	246
17. Donkhlebbank <i>Rostov-on-Don</i>	R, up to 90 per cent	1 year 50-70 per cent	M, L, E	26

D- dollar

R- ruble

M- mortgage contract

L- lease-purchase contract

E- guarantee of the enterprise

In 1997 a number of banks started preparations for mortgage lending (Most-Bank, Conversbank, AKB "Petrovsky", Technobank, etc.). A 1997 sample survey of the banks by the Urban Institute gave an idea of the shaping changes in mortgage lending market development. In general loan term tended to increase. Some banks started making loans for 5 and even 10 years.

Using the classic home purchase mortgage was becoming more and more interesting to the banks. Partly this can be accounted for by the fact that the banks grew more attentive to targeted use of loan funds; and the gained experience showed that default on loans given with the purpose of home purchase is rather insignificant and can be minimized with the right evaluation of the borrower's feasibility. There was a trend towards interest rate reduction, especially on loans in rubles. Table 5.5 gives a brief characteristics of the basic terms of mortgage lending end of 1997.

Table 5. 5
The Basic Terms of Housing Mortgage Lending by End of 1997

<i>Bank</i>	<i>Annual interest rate</i>	<i>Term</i>	<i>LTV</i>	<i>Guarantee</i>
“SBS-AGRO”	19-22.1 per cent in currency	1-10 years	not more than 70 per cent	lease, mortgage
Moscow branch of the Sberbank of Russia	23 per cent in currency 31 per cent in rubles	3-10 years	not more than 70 per cent	guarantee
Diamant	23 per cent in currency	up to 5 years	not more than 70 per cent	lease, mortgage
Investsberbank	27 per cent in currency 33 per cent in rubles	up to 2 years	not more than 70 per cent	lease, mortgage, guarantee
Probusinessbank	20-25 per cent in currency 30-35 per cent in rubles	up to 3 years	up to 70 per cent	lease, guarantee
Inkombank (St. Petersburg)	22 per cent in currency 35 per cent in rubles	up to 1 yeas	not more than 70 per cent	lease

Residential Construction Finance

In 1995 - 1997 an all-out effort was made to encourage the development of the construction finance market in Russia. *The Residential Construction Finance* project was focused on the design of reliable and beneficial schemes of finance for developers and construction companies involved in housing production, and on harmonization of bank lending rules and patterns with the current Russian economic environment.

At the beginning, attention was focused on the four priority cities: Moscow, N. Novgorod, Ryazan and Vladimir oblast. Due to the lack of interest and possibilities of Vladimir regional banks to participate in construction period finance project, Vladimir region was replaced by Ekaterinburg region. One of the major reasons for such a replacement was Ekaterinburg participation in the World Bank Housing Project.

In the second year, special attention was given to banks in the four Regional Centers. But the project worked with a number of additional banks in Moscow and the regions as resources permitted.

One of the major objectives of the project was to stimulate interest by investors, developers and enterprises in construction loans, along with enhancement of banks' involvement in the lending projects of that kind. Another project objective was the development of application standards for prospective borrowers, and rules and procedures for processing applications by lenders. Harmonization of application and project proposals standards with the essential features required of them by banks is bound to facilitate legal and contracting procedures of residential construction finance.

The project team contacted a broad range of finance institutions, construction companies, municipal and governmental authorities involved in the real estate market regulation both at local, and federal levels. But, first and foremost, the attention was focused on the work with commercial banks which already had an experience in construction lending. At the same time the project

provided its assistance to municipal authorities and construction and investment companies cooperating with the bank-project clients, in implementation of their joint construction projects. In addition, meetings and seminars held under the Project, were attended by delegates from companies and banks which failed to come into direct contact with the project team, but showed their interest in construction lending.

Project activity on promoting various residential construction financial schemes incorporated the following major components:

- research and technical assistance in the development of the housing construction finance methodological framework, based on the world standards and adjusted to the current Russian economic environment;
- advice to banks and their partners on the design and implementation of specific programs of residential construction lending;
- extensive training on real estate finance provided to the personnel of the banks and companies concerned;
- assistance in drafting loan applications, business plans and project proposals for residential construction lending

In Table 5.6 a summary is presented of selected lending of this type for some of the banks with which the project worked. As shown in the final column, these banks have been originating loans, often a significant number of them.

Table 5.6

The terms of construction period lending by major participants of the Project (1995 - 1997)

<i>Name of Bank</i>	<i>Borrower's Type</i>	<i>Loan Amount</i>	<i>Loan Period</i>	<i>Loan Interest Rate</i>	<i>Interest Period</i>	<i>Security</i>	<i>Number of loans originated</i>
MENATEP (Moscow)	Individual developers	25,000 USD for land purchase; 35,000 USD for cottage construction	up to 5 years	25 per cent annually in USD	1 month	outside guaranties and pledge of real estate property rights	25
SBS-AGRO (Moscow)	Investment and construction companies	from 500,000 USD to 5,000,000 USD, average sum of loan 1,000,000 USD	from 1 to 2 years	from 38 per cent to 45 per cent annually in USD	1 month	pledge of real estate property rights and real estate under construction, rights' reassignment of contract requirements, land plots for construction (rent or property rights)	15
TOKOBANK (Moscow)	-	-	-	-	-	bank is under sanation	-
S. Petersburg Bank (St. Petersburg)	Investment and construction companies, municipal construction companies	from 100,000 USD to 5,000,000 USD	from 18 months to 3 years	LIBOR + 15-17 per cent	1 month	outside guaranties and pledge of real estate property rights, local authorities guaranties	14
Promstroybank (St. Petersburg)	Investment and construction companies,	from 100,000 USD to 3,000,000 USD	from 18 months to 4 years	LIBOR + 14-16 per cent	1 month	outside guaranties and pledge of real estate property rights, local	8

<i>Name of Bank</i>	<i>Borrower's Type</i>	<i>Loan Amount</i>	<i>Loan Period</i>	<i>Loan Interest Rate</i>	<i>Interest Period</i>	<i>Security</i>	<i>Number of loans originated</i>
Mosbusinessbank (Moscow)	municipal construction companies Investment and construction companies	from 200,000 USD to 10,000,000 USD	from 6 months to 5 year	LIBOR + 15-17 per cent	1 month	authorities guaranties outside guaranties and pledge of real estate property rights, rent of property rights for land plots	17
Novobank (Novgorod)	Investment and construction companies, municipal construction companies	from 3 million rubles to 70 million rubles	from 6 months to 5 years	refinance rate of CB in Rubles + 2-6 per cent	1 month	outside guaranties and pledge of real estate property rights, the property rights for land plots	9
Uralpromstroybank (Ekaterinburg)	Individual developers, investment and construction companies	from 5 million rubles to 70 million rubles	from 1 to 4 years	refinance rate of CB in Rubles + 3-7 per cent	1 month	outside guaranties and pledge of real estate property rights	11
Ural commercial industrial bank (Ekaterinburg)	Individual developers, investment and construction companies	from 3 million rubles to 50 million rubles	from 1 to 3 years	refinance rate of CB in Rubles + 3-7 per cent	1 month	outside guaranties and pledge of real estate property rights	18
Sokolbank (Cherepovez)	Investment and construction companies	from 0.5 to 20 million rubles	from 6 months to 2 years	refinance rate of CB in Rubles + 4-6 per cent	1 month	outside guaranties, land plots for construction (rent or property rights)	4
NBD Bank	Investment and	from 20,000 USD	from 2	LIBOR	1 month	outside guaranties and	7

<i>Name of Bank</i>	<i>Borrower's Type</i>	<i>Loan Amount</i>	<i>Loan Period</i>	<i>Loan Interest Rate</i>	<i>Interest Period</i>	<i>Security</i>	<i>Number of loans originated</i>
(N. Novgorod)	construction companies, municipal construction companies	to 100,000 USD	months to 18 months	+ 12 per cent		pledge of real estate property rights	
East-Siberian commercial bank (Irkutsk)	Individual developers, investment and construction companies	from 10 to 50 million rubles	from 6 months to 2 years	refinance rate of CB in Rubles + 2 per cent	1 month	outside guaranties and pledge of real estate property rights, the property rights for land plots	12
Priovneshtorg-bank (Ryazan)	Investment and construction companies	from 5 to 40 million rubles	from 3 months to 2 years	refinance rate of CB in Rubles + 3-5 per cent	1 month	pledge of property rights of real estate under construction, rights' reassignment of contract requirements, land plots for construction (rent or property rights)	10
ZHIVAGO-BANK (Ryazan)	Investment and construction companies, share participants of construction (population)	from 10 to 50 million rubles	from 1 month to 1 year	refinance rate of CB in Rubles + 3 per cent	1 month	pledge of property rights of real estate under construction, rights' reassignment of contract requirements, land plots for construction (rent or property rights)	39

All the banks required not less than 20 per cent-50 per cent borrower's own capital investment for project's construction

One of the major Project components was to work with commercial banks, and with their managerial staff and senior offices supervising the construction lending operations, in particular. Throughout the period from 1995 to 1997 the number of banks - Project participants increased from 13 in 1996 to 28 in 1997. Below is the list of banks with which IUE was in continuous contact.

Table 5.7
Russian Banks Cooperating with HSRP on Construction Finance

##	Bank	City	Start in the Program	Number of meetings with the bank	Number of the bank staff participated	Active / Not active in RCL in summer 1998
1.	Sokolbank	Cherepovets	1995	12	5	NA
2.	East-Siberian Commercial Bank	Irkutsk	1995	10	6	A
3.	Diamant	Moscow	1996	3	2	NA
4.	Incombank		1997	4	3	A
5.	Joint Industrial Bank		1997	9	2	A
6.	Lights of Moscow		1997	3	2	NA
7.	MENATEP		1995	17	3	A
8.	Mosbusinessbank		1995	14	4	NA
9.	Moscow bank of the Sberbank of the RF		1997	5	3	A
10.	Most-bank		1997	4	3	A
11.	Sberbank of the RF		1997	4	2	A
12.	SBS-AGRO		1995	15	4	A
13.	Vostok- Zapad		1997	2	2	A
14.	NBD Bank	Nizhniy Novgorod	1996	4	1	A
15.	Nijhegorodsky Regional Center of Incombank		1997	2	1	NA

##	Bank	City	Start in the Program	Number of meetings with the bank	Number of the bank staff participated	Active / Not active in RCL in summer 1998
16.	Novobank	Novgorod	1995	9	5	A
17.	Priovneshtorgbank	Ryazan	1996	8	4	A
18.	Zhivago-Bank		1996	10	3	A
19.	Baltiysky	St. Petersburg	1997	3	1	NA
20.	Petrovsky		1997	3	1	A
21.	Promstroybank		1995	6	4	A
22.	St. Petersburg		1995	11	6	A
23.	Dalnevostochniy	Vladivostok	1997	4	4	A
24.	Dalrybbank		1997	3	3	A
25.	First Primorskiy		1997	3	2	A
26.	Primor'e		1997	1	1	NA
27.	Ural Commercial Industrial Bank	Yekaterinburg	1996	7	5	A
28.	Uralpromstroybank		1996	8	4	A

Receipients of advice from the project, first of all included those mostly interested in promoting this type of lending. Alongside with the banks which had already proceeded to construction lending, IUE endeavored to cover also those that were just exploring the idea of entering this market segment. Hence, IUE consultations were rather diversified and addressed the various problems of construction finance, including:

- research and technical assistance in the development of the housing construction finance methodological framework, based on the world standards and adjusted to the current Russian economic environment;
- recommendations to banks on structuring their construction lending systems flow;
- design of residential construction lending strategy for banks;
- advise on conducting the housing market analysis, evaluation of construction projects and underwriting of borrowers;
- Development of construction loan application standards;

- Recommendations on the design and use of cash flow analysis when reviewing construction projects;
- Recommendations on construction loan structure and minimization of lenders' risks;
- Aspects and instruments of construction finance management;
- Development of the model loan documentation and other standard documents for residential construction finance;
- Providing advice on legal aspects of residential construction finance;
- Summarizing inner and world expertise in residential construction finance.

Of particular interest for bankers were the issues on construction loan structure, minimization of loan risks, cash flow simulation, phased-in loan management correlated with the progress in a construction project. Several banks already possessed some knowledge in construction lending. Primarily, those were the banks that were converted from the former soviet credit institutions, including their regional affiliates. Some of them were engaged in construction finance, though their operations in that field of banking were limited to preliminary examination of the construction component of construction lending projects, verification of building permits and approvals, and subsequent (upon project approval by the head bank) disbursement of loan funds through which design, survey and construction works were financed, with simultaneous establishment of engineering and technical supervision over the project. Hence, with the transition of Russian economy to the market, nearly all banking institutions were in need of development of new financial schemes and loan instruments, underwriting procedures, cash flow and cost benefit analyses, loan administration, in particular bad loans management.

In some instances IUE staff were involved in on-site examination of applications entered to a bank with a request to raise a construction loan. Having closely examined them, IUE consultants supplied banks with their comments and recommendations on applications' consistency with the standard and risk management requirements. As a rule, the banks gave due consideration to IUE recommendations when working with borrowers. In some instances IUE staff provided advice to banks throughout the whole period of implementation of a construction lending project, being helpful in the solution of various difficulties and problems.

For example, IUE was deeply involved in implementation of the housing rehabilitation finance project undertaken by the Cherepovets commercial bank, Sokolbank, which was one of the most active Project participants. IUE staff jointly with the bank analyzed the project, its financial schemes, in particular, and drew up a chart of the project finance out of the borrowed funds and a schedule for loan repayment. The project construction period extended over 12 months, while the loan was extended for 10 months. With the completion of the project, the loan was refinanced through the proceeds from the sale of units in the constructed building, and through mortgages extended by the bank to citizens who wished to purchase an apartment in it. Currently nearly all mortgages (extended for 2 years term) are repaid, and the bank received its expected return on its money.

Alongside with the contacts with bank personnel, IUE staff met with representatives of the construction companies - prospective borrowers who would like to raise a construction loan and, thus, were involved in execution of a required set of documents. The chief topic of the discussions was the loan application procedures and the data required for reporting.

Loan documentation forms and models presented by IUE team were by far the most interesting point for the banks. There were instances when banks used them as the basis for the development of their own loan documents, among them were the SBS-Agro Bank (Moscow), Saint-Petersburg Bank (Saint-

Petersburg), Irkutsk affiliate of the Vostochno-Sibirsky Commercial Bank, URALKIB Bank (Yekaterinburg), Sokolbank (Cherepovets) and others. Nearly all banks actively employed the IUE materials and recommendations for designing their own lending rules and procedures, functional restructuring of their units involved in residential construction lending, compiling analytical reports on proposed projects and applications, and proceeding to the practical work on loan origination and management.

Banks in the program which received technical assistance under HSRP I and HSRP II will be encouraged to continue their current relationship, but on a fee basis. The Institute for Urban Economics will become a leading institution for housing finance information, research, and innovation. Generating fee income to support the Institute for Urban Economics will be a major consideration. Banks will be asked to pay consultancy fees for work performed by staff consultants trained under HSRP I and HSRP II. Fees will also be charged for direct consultations with bank staff, training to the bank's affiliates, and speaker's fees. An overall fee schedule will be developed to encompass staff consultations, training, and computer software.

Assistance to Developers. The language in the HSRP II contract envisioned and the workplan for 1995-1996 included a program for providing two types of assistance to housing developers.

1. It was believed that a principal reason that banks were not engaged in construction period lending was the lack of effective demand for such loans. Effective demand was evidenced by both a small number of inquiries and applications and the poor quality of applications submitted by developers who did seek bank financing. The program of technical assistance was to provide assistance to developers in defining projects for bank finance and preparing an application to banks.
2. There was also the view that it is realistic to foster public-private partnerships between developers and local administrations for residential and commercial development projects. Again, technical assistance would be provided to help structure such projects and to seek bank financing for them.

Both activities were targeted on the four USAID-priority cities. The same team of consultants, from the firm PADCO, work on both tasks.

In the event, both local administration officials and developers expressed little interest in pursuing public-private partnerships; and this activity was discontinued after a few months. There was greater, but still modest, interest among developers for assistance in seeking bank financing for construction projects. Even here, however, in one city, Vladimir and Ryazan, no significant interest was identified; and Ekaterinburg and Tver, where several developers were actively interested, were substituted for them. Later, as it became clear that the project consultants could handle a heavier work load, St. Petersburg was added.

Ultimately, the project team worked at some level with nearly 40 developers and quite intensively with about half this number. Nine developers submitted well-developed proposals to banks for financing. The distribution of applications was: Yekaterinburg-3; Moscow-3; Nizhni Novgorod-2; and, Tver-1.

In general, however, developer interest was restrained as they were unconvinced that banks would in fact lend to them. The more sophisticated among them also had a quite good idea of how to prepare a solid application. In some markets, such as Moscow and St. Petersburg, local firms could also provide these services.

The project laid the ground work for providing training to additional developers by preparing quality applications by preparing a "how to" manual aimed at developers and a instructor's manual for teaching a course substantially based on the manual. These materials incorporate the practical, real-world experience gained through working with the developers on concrete projects.

Finally, Russian specialists were two of the four persons working on the project. By its conclusion, these specialists were ready to offer the training course without U.S. adviser assistance.

Training

HSRP II conducted training in both mortgage and construction period finance. The project's earlier experience with the Association of Mortgage Banks as the primary training facility for the mortgage lending industry was disappointing because the Association had not been very energetic in its activity. While the potential market for training is limited, we believed that this market would continue to grow. In order to maintain high standards and the effective dissemination of information, the Urban Institute began to concentrate its efforts on establishing the Institute for Urban Economics as the primary source for training in housing finance. IUE offered courses jointly with other institutions, with IUE providing the trainers. Fee income generated from the training seminars will go towards continued growth of the IUE. In some cases, we provided tuition scholarships for staff from priority banks that are showing genuine progress.

Construction period finance. Within 1995 - 1997 12 training seminars on residential construction finance were held. The seminars were attended by delegates from commercial banks and companies - bank partners collaborating with them in various fields construction lending. The seminars covered various regions of Russia, including Moscow, Yekaterinburg, Vladivostok, Voronezh, Perm, etc. (see table below). In early April, 1996, one of the seminars--a study visit-- was staged in Washington and New-York. 14 Russian bankers attended this seminar. A number of separate presentations on residential construction lending issues have been made during several other seminars and conferences, not included in the table 5.8. Overall more than 170 students have participated in the formal seminars on Residential Construction Lending issues (the total number of attending some lectures is more than 500). Fifteen UI/IUE professionals participated in several of the seminars as students as well.

Noteworthy is the interest in the seminars not only from the side of bankers, but also from cities' housing and construction communities. Among communities' delegates there were specialists of some construction and investment companies, municipal executives, representatives of local self-governments.

In this period two 3-days standard training courses were developed. Both courses - Fundamentals of Housing Construction Lending and Housing Construction Finance Practice - are meant for banking personnel. The courses were extensively tested at seminars, the corresponding course materials were disseminated among seminar participants. Both of the courses were developed on the basis of the "Basics of Residential Construction Lending" Instructor's Guide prepared in 1994 by the Urban Institute and the Fannie Mae (USA).

Mortgage finance. Seminars on development of long-term housing mortgage lending were conducted in Vladivostok, Rostov-on-Don, Irkutsk, Kiev, Saratov (See Table 5.9).

At these seminars different aspects of housing mortgage lending, possibilities of introducing mortgage operations into bank practice, problems related to mortgage lending, mortgage schemes, legal matters came under interested discussion.

In addition, a series of seminars on secondary mortgage market, origination of mortgage loans, collection of fees and payments in mortgage lending was organized with participation of Fannie Mae representatives. The seminar was attended by banks interested in mortgage activity.

Table 5.8
Training seminars organized within the Residential Construction Lending Project

##	Location	Dates	Topic	Number of participants
1.	Moscow	February 13-17, 1995	Residential Construction Lending	24
2.	Moscow	November 21-24, 1995	Principles of Residential Construction Lending	35
3.	Moscow	February 27 - March 1, 1996	Practical Aspects of Residential Construction Lending	30
4.	Washington, D.C.; New York (USA)	April 2-14	Practice of Residential Construction Lending	14
5.	Sochi	September 23-26, 1996	Practice of Residential Construction Lending (Follow-up Seminar)	12
6.	Tumen	June 8, 1996	Residential Construction Lending in Russia (integrated in 2-day seminar "Problems of Mortgage Lending")	40
7.	Vladivostok	November 27-11, 1996	Residential Construction Lending in Russia (integrated in 2-day seminar "Problems of Mortgage Lending")	45
8.	Voronezh	February 12, 1997	Residential Construction Lending in Russia (integrated in 1-day seminar "Problems of Mortgage Lending")	50
9.	Perm	March 3, 1997	Residential Construction Lending in Russia (integrated in 1-day seminar "Residential Mortgage and Construction Lending")	32
10.	Novgorod	October 27-28, 1997	Residential Construction Lending in Russia (integrated in 2-day seminar "Basics of Commercial and Residential Real Estate Lending")	11
11.	Nizhniy Novgorod	November 3-5, 1997	Residential Construction Lending in Russia (integrated in 3-day seminar "Basics of Commercial and Residential Real Estate Lending")	17
12.	Yekaterinburg	November 19,	Practice of Residential Construction	31

<i>##</i>	<i>Location</i>	<i>Dates</i>	<i>Topic</i>	<i>Number of participants</i>
		1997	Lending	

Table 5.9
Seminars on development of long-term housing mortgage lending

##	Location	Dates	Topic	Number of participants
1.	Vladivostok	November 24-25, 1996	Residential Mortgage Lending in Russia. Problems and perspectives.	56
2.	Rostov-on-Don	October 28-29, 1996	Residential Mortgage Lending in Russia. Problems and perspectives.	65
3.	Saratov	July 8-9, 1997	Residential Mortgage Lending in Russia. Problems and perspectives.	106
4.	Kiev	April 22-23, 1997	Residential Mortgage Lending. Problems and perspectives.	54
5.	Irkutsk	April 9-10, 1997	Residential Mortgage Lending in Russia. Problems and perspectives.	47

The “Certified Mortgage Lender” Program. The idea of developing the “Certified Mortgage Lender” program came up in 1996. Its foundation was a 3-year experience by the staff of the Urban Institute and the Institute for Urban Economics within the framework of USAID program for technical assistance to Russian banks in organizing their mortgage lending operations.

The Fund’s activity on promoting long-term mortgage lending in Russia significantly resulted in, first, standard bank requirements to the borrower and standard procedures of feasibility evaluation, second, classical housing purchase mortgage loans driving out pseudo-mortgage lease loans and, third, introduction of loan instruments with annuity payments.

The “Certified Mortgage Lender” program developed by the IUE with the assistance of experts from the Urban Institute (USA) and Federal National Mortgage Association of the USA incorporates experience of Russian banks in mortgage lending and international standards of origination and servicing of such loans.

The program serves as a standing training facility for bank personnel in the field of housing mortgage lending. The main issues addressed by the Program are:

- legal framework for mortgage lending
- basic stages and procedures of mortgage lending
- standard forms used in origination and servicing of mortgage loans
- procedures for evaluating paying capacity of potential borrowers and repayment probability

- for the loans granted for purchase of housing
- servicing of housing mortgage loans and measures to ensure their repayment
- international loan instruments and their adjustment to conditions in Russia
- risk management and pricing in mortgage lending

The program took on a new meaning in 1997 when Agency for Housing Mortgage Lending was established for buying mortgage loans made in conformity with the Agency standards from commercial banks. The partner-banks on the secondary mortgage market were selected by the Agency on the basis of availability of bank personnel trained under the “Certified Mortgage Lender” Program.

The main aims of “Certified Mortgage Lender” Program.

- setting quality standards for training of experts in housing mortgage lending to population- a newly forming banking activity in Russia
- training highly qualified bank experts on housing mortgage lending
- creating an association of professionals interested in and actively promoting formation and development of modern system of mortgage lending with the purpose of making it a flourishing banking business

Program Structure. The program consists of 3 courses, each for 5 working days (more than 100 academic hours):

- Course 1 “Basics of Housing Mortgage Lending”
- Course 2 “Origination and Servicing of Mortgage Loans”
- Course 3 “Basics of Pricing and Risk Management in Mortgage Lending”

The courses can be taken in random order. On the last day of each course a written test is held and regarding its results a Certificate is given. After the participant has taken all 3 courses and passed the examinations, he receives an individual number Certificate of the “Certified Mortgage Lender” program completion. The information about the certificate holder is entered into a special register kept by the Institute for Urban Economics.

The scope of the first course “Basics of Mortgage Lending” covers:

- 1) The history of mortgage lending development in Russia
- 2) Basic components and stages of the mortgage lending process
- 3) Characteristics of the basic risks in mortgage lending
- 4) Foreign experience in creating the system of housing mortgage lending to population
- 5) Regulatory framework for mortgage lending in Russia
- 6) Legal provision for the housing mortgage lending process
- 7) Loan instruments used by American and European banks in mortgage lending and the possibility of their adjustment to conditions in Russia
- 8) Loan instruments used in countries with high inflation (as an alternative to fixed-rate loans)
- 9) Preliminary qualification of the borrower and filling out an application for a housing mortgage loan

- 10) Evaluation of loan repayment probability (underwriting)
- 11) Modern business conditions and trends in development of Russian housing market
- 12) Basic methods for appraisal of residential properties
- 13) Primary and secondary mortgage markets and the role of the Agency for Housing Mortgage Lending
- 14) Housing savings programs of Russian banks
- 15) Russian banks activity in mortgage lending to population: problems and prospects of development.

The second course “Origination and Servicing of Mortgage Loans” gives a detailed insight into the following issues:

- 1) Basic tasks and functions of the Agency for Housing Mortgage Lending
- 2) Legal side of the Agency’s activity and regulation of relations between the Agency and banks
- 3) Qualification of the borrower in the process of loan underwriting
- 4) Servicing of mortgage loans in a bank
- 5) Standard forms for bank reports used when servicing mortgage loans
- 6) Cooperation of commercial banks and realties in housing lending
- 7) Basic legal issues to be addressed in the loan documentation (loan and mortgage contract)
- 8) Cooperation of the Agency with commercial banks in servicing the loans sold to the Agency
- 9) The system of state registration of real estate rights and transactions
- 10) The place and role of state subsidies to population for home purchase in the system of housing finance

The second course also includes practical computer classes on: “Mortgage Loan Application”, “Calculation of Payment Schedules and Servicing of Loans”, and a business game “Mortgage Loan Origination”, directed at developing the skills for analysis, calculation and collection of payments.

The third course of the Program “Basics of Pricing and Risk Management in Mortgage Lending” is structured to give maximum attention to the following issues:

- 1) Analysis and evaluation of risks involved in mortgage lending to the population
- 2) Credit risk and interest rate risk
- 3) Evaluation of liquidity risk, option risk and interest rate spread risk in mortgage lending
- 4) Accounting for risks involved in setting interest rates and selection of loan instrument
- 5) Developing a business plan for mortgage department of a commercial bank and planning of bank’s mortgage operations
- 6) insurance in the system of mortgage lending
- 7) experience of organizing a market of mortgage-backed securities in countries with a developed system of lending for home purchases

The third course also includes practical computer classes on: "Analysis of Cash Flows in Mortgage Loans" and "Business plan for Mortgage Department in a Bank" developed by experts from the Institute for Urban Economics.

Participants of the courses are provided with materials on all lectures and sets of documents used by Russian banks in mortgage lending.

The set of documents given to trainees also incorporates the Agency's mortgage lending requirements to partner-banks, standard forms (borrower preliminary qualification form, mortgage loan application form, evaluation of the loan repayment possibility, etc.), report forms and other documents necessary for cooperation of the Agency for Mortgage Lending and commercial banks, making loans with the purpose of their further selling to the Agency.

The papers on the Agency's cooperation with banks were worked out by the Institute's staff together with the experts of the Federal Association of Mortgage Banks of the USA ("Fannie Mae").

Participants of the Program. The contents of the courses is aimed mostly at personnel of banks loan departments engaged in originating loans to natural persons, as well as personnel of realties and construction companies working with banks on joint projects for construction and sale of housing by an installment plan.

The number of banks actively collaborating with the Institute in developing the system of mortgage lending is constantly growing. This results in on-going updating of the program to reflect changes in the economic situation and regulatory framework. Apart from theoretical training the participants of the seminars have a rare possibility to share practical experience on origination and servicing of housing mortgage loans.

From December 1996 to May 1998 the Institute for Urban Economics made two full offerings of the "Certified Mortgage Lender" Program (each comprising 3 courses) and a third offering of two courses. In the one and a half years since launching of the Program 57 specialists on housing mortgage lending were trained. Among them were employees of the banks listed in Table 5.10.

Table 5.10
Summary of Banker-Participants in the Certified Mortgage Lender Course
(number of persons trained in parentheses)

Moscow	SBS-Agro (2), Inkombank (3), Promstroybank of Russia (1), Dialog-Bank (2), Investsberbank (1), Diamant(3), CB "Neftyanoy"(1), Sobinbank (1), BFG-Kredit (2), "Belcom" Bank (1), National Mortgage Bank (2), Probusinessbank (1), East-European Investment Bank (1)
St. Petersburg	"St.Petersburg" Bank (2), "Petrovsky" Bank (2)
Tjumen	Joint Stock Bank "Tjumen-Express" (1)
Yekaterinburg	SKB-Bank (1), Sberbank-Yekaterinburg(2), Municipal Bank (1)
Cherepovets	Sokolbank (1)
Irkutsk	VostSibKomBank (1)
Rostov-on-Don	CB"Zentr-Invest" (1), Joint Stock Bank "Donkhlebbank (1)

Chita	“Zabaykolzolotobank” (1)
Orenburg	CB “Rus” (1)
Kazan	“Kazansky” Bank (1), Intechbank (2)
Krasnoyarsk	CB “Kedr” (1)
Lipetsk	CB “Menatep”-Lipetsk department

Apart from bank personnel, the Program enrolled:

- staff of the Agency for Housing Mortgage Lending (4), Orenburg Mortgage Corporation (1), Mortgage Corporation of Tatarstan “Tatipoteka” (2),
- sales managers and staff of financial departments of construction companies (“Podmoskovye” corporation (1), Joint Stock Company “Promstroyinvest”(2), Closed Joint Stock Company “Fortress” (Moscow- 2), Lipetskmetalstroy (1), Lipetsk Construction Department (1)
- experts from the realty “Real Estate Agency” (Yekaterinburg- 1).

The Program had its first graduates from December 1996 to June 1997, then from October 1997 to March 1998 a second group of graduates and from April 1998- to June 1998 a third group.

The faculty. Sessions under “Certified Mortgage Lender” Program are mostly conducted by the specialists of the “Institute for Urban Economics” who alongside basic theoretical knowledge have a bank track record and practical experience in granting and servicing mortgage loans. Practically all lecturers of the Institute have taken courses on programs for Housing Financing in the USA, organized by the Association of Mortgage Banks of the USA (“Fannie Mae”).

Institutionalization

The Institute for Urban Economics assumed its role as the primary source for the dissemination of information on mortgage and construction period lending. The department, headed by a Russian professional, continues to work with Russian banks on firmly establishing the industry. Mortgage lending continues to be an important activity with the IUE, but at a diminished level of effort. Emphasis has been placed on making the consulting group leaner and self-sustaining. Some staff members already trained in mortgage lending have been transferred to other areas including construction finance and commercial mortgage lending.

Development and dissemination of guides and aids

One of the Project tasks implied the development of advisory materials: guides and booklets promoting the updated schemes of residential construction finance and mortgage finance. For the reported period the following products were published and disseminated:

Construction finance.

1. *The Program of Residential Construction Finance in the Russian Federation*
2. *Recommendations on Real Estate Market Analysis for Originating Construction*

Loans

3. Cash Flow Simulation for Residential Construction Lending Projects

Collection of regulations and recommendations titled *The Russian Federation Program of Residential Construction Finance* contains materials on how to upgrade the work performance of bank units engaged in housing construction lending, conduct economic and financial analysis of the housing market and prospective borrowers, on how to maintain loan histories and review construction projects, develop procedures for residential construction loans origination and management. The collection incorporates the set of model documents which may be useful for reviewing loan histories and managing construction loans. *The Russian Federation Program of Residential Construction Finance* was designed for commercial banks and was disseminated among IUE clients. Some of them have already applied the proposed recommendations in their day-to-day work.

Two more guides - *Recommendations on Real Estate Market Analysis for Originating Construction Loans* and *Cash Flow Simulation for Residential Construction Lending Projects* - address the specific features of relevant stages of construction lending and suggests recommendations on the most advantageous modes of systems flow management. The booklets disseminated among IUE clients were highly appreciated by them.

Mortgage Finance. A series of booklets and articles on separate questions of housing mortgage lending was prepared and published. In particular, a series of booklets on “Housing Finance” in Russia was published. It included booklets on:

1. “Legal aspects of housing mortgage organization and documentation”
2. “Features of the DAIR loan instrument developed for Russia”
3. “Guidelines on origination of housing mortgage loans developed for Russia”
4. “Manual on organization and procedures of servicing mortgage loans”
5. “Calculation of interest rate on mortgage loans in Russia: methodological approach”
6. “Evaluation of mortgage loan repayment possibility (underwriting)”
7. “Brief description of software for servicing of housing mortgage loans”
8. “Functions and organization of legal department in a mortgage bank”
9. “Bridge Loan Program”
10. “Housing Improvement Loan Program”
11. “Recommendations on Using Housing Savings Programs in Bank Practice”.

In 1997 some issues of this series were updated. Also “Concept of Financial Lending Mechanism for Ensuring Housing Affordability” and “Program for Making Loans for Condominium Reconstruction” were published.

6. Agency for Residential Mortgage Lending

At the birth of the Russian Federation in 1991, mortgage lending was non-existent. There had been a very limited volume of long-term signature loans for purchase or construction of single-family units in the countryside, but not even these loans were available in even middle-size cities. The combination of no legal basis for collateralized lending and the frightening economic instability of 1992-1995 created a distinctly uninviting environment for the development of mortgage lending.¹⁴

Against this background it is remarkable that Russia is the first country in the former Soviet bloc to have a secondary facility to purchase mortgages: the Agency for Housing Mortgage Lending.¹⁵ This development happened for five fundamental reasons:

1. Sberbank, the former State Savings Bank, stopped making home purchase loans in 1993 after it had been burned on its outstanding portfolio of very low interest rate-fixed rate loans: this opened the way for private banks to enter the market without a strongly advantaged competitor;
2. a minimally adequate legal base was created;
3. after the "easy money" years when banks could make comfortable profits through exchange rate operations and investing in short-term government securities, home mortgages were identified by many banks as having an attractive risk-adjusted rate of return;
4. the Government has had a steadfast policy of attracting private finance to the housing sector; the Agency for Housing Mortgage Lending is the most conspicuous example of this policy; and
5. the sustained assistance provided by USAID in developing the primary market and then creating the Agency for Housing Mortgage Lending.

The pressure for the creation of the Agency, however, came from commercial banks. As a group they do not want to make and hold long-term loans. In Russia liquidity is of paramount importance to banks. Put simply, in response to Government promotion of mortgage lending the banks said they would only increase the volume of such lending if there were a liquidity facility to refinance their loans.

In October 1998 the Agency will purchase its first mortgages from two "pilot banks" in St. Petersburg. Purchase volumes will be deliberately low in the following few months while the Agency's various systems are tested and refined. After obtaining a loan from a donor agency or its first debt issuance, expected in the spring or summer of 1999, larger scale operations will begin.

The first part of this chapter provides additional information about the Agency's structure and operations. The second describes technical assistance provided to the Agency under the project.

14. For a description of the early development of mortgage lending see: N. Kosareva and R. Struyk, "Emerging Long-Term Housing Finance in Russia," *Housing Finance International*, March 1996, pp. 20-30; and, R. Struyk and N. Kosareva, "Developing the Russian Housing Finance System," *Housing Finance International*, March 1993, pp. 2-9. The current situation in mortgage lending is reviewed in chapter 5 of this report.

15. In the past ten years, numerous countries have created secondary facilities or have considered doing so. See, for example, M. Myberg, "The Use of Securitization by Investors and Issuers in International Markets," in L.T. Kendall and M.J. Fishman (eds.) *A Primer on Securitization* (Cambridge: MIT Press, 1996), pp. 139-52.

The Legal Base

Two distinct legal constructs are relevant to the Agency's operations: the acts underlying its creation and the acts governing the use of mortgages in Russia.

The Agency. The Agency was first created by a Presidential Decree in December 1993, but it was activated by two Resolutions of Government in 1996.¹⁶ The legislation assigns the Agency the tasks of being a liquidity facility for housing lending and organizing mortgage lending in Russia by setting standards on the loans it will purchase. The Agency is created as an independent open joint stock company, with the Government of Russia owning at least 51 percent of the shares. (Initially the Government is the sole shareholder.) One Government Resolution also names a Board of Supervisors, which includes representatives from all the relevant government bodies, including the securities commission, as well as the Central Bank and five commercial banks. It is chaired by the Minister of Construction.

With respect to financial terms, the legislation authorizes an equity payment of 450 billion (old) rubles. It also states that the Government of Russia will fully guarantee debt issued by the Agency. (The guarantee is the primary reason for the requirement that the Government hold majority interest.) The Agency's debt is not accorded any tax advantages. Following the initial payment of capital by the Government, the Agency was registered in September 1997.

The Agency received its license in August this year from the Central Bank of Russia as a non bank financial institution. The Agency applied for this status primarily because of the financial advantages of issuing debt as a non bank financial institution rather than a joint stock company. In particular, banks can count bond interest and some associated bond management fee as expenses in computing its taxable income whereas as a simple joint stock company cannot. Having this license also places the Agency under the supervision of the Central Bank and facilitated obtaining Central Bank agreement for certain changes in banks' accounting for mortgage sales and pass through interest payments.

Mortgage Law. The Law on Pledge was passed in 1992 which along with laws covering administrative procedures provided a minimum base for mortgage lending. Part II of the new Civil Code, passed in December 1995 was significant in leaving many provisions to be filled in by the Law on Mortgage when it was passed. The Civil Code also established that while the loans of mortgagors in default could be foreclosed, the mortgagor could not be evicted. The Law on Mortgage of July 1998 amends this provision in the borrowers who pledge their housing unit as collateral in order to purchase it can be evicted for non payment.¹⁷ The law also generally establishes a reasonable basis for mortgage lending.

Loan Product Purchased

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16. Presidential Decree No. 2281, "On Developing and Implementing of Extra-Budgetary Forms of Investment into the Housing Sphere," December 24, 1993. Russian Federation Government Resolution No. 753, "On the Federal Targeted Program 'Your Own Home'," June 27, 1996. Russian Federation Government Resolution No. 1010, "On Agency for Housing Mortgage Lending," August 26, 1996.
 17. The Law on Mortgage of 1998 is the same as the law passed by both houses of parliament a year earlier but which was vetoed by the President because it contained a provision prohibiting the mortgage of agricultural land. In 1998, the parliament overrode the President's veto after negotiations with the Administration over changes to the law proved fruitless.

The Agency will purchase qualifying loans, i.e., it purchases the right of claim. The mortgagee assigns ownership rights for the loan to the Agency; this assignment is registered, and the Agency takes possession of the original loan documents. The Agency in turn assigns servicing rights to the mortgagee under a trustee agreement. For reference, the counterpart U.S. model is the "Fannie Mae portfolio program."

While the Agency plans to purchase several types of loans eventually, it will begin by purchasing one loan type. The principal attributes of the product are as follows. It is a conventional mortgage note and contract. Loans are variable rate and dollar denominated: the interest rate is tied to the interest on borrowed funds (LIBOR); and, payments are computed in dollars then converted to rubles using the dollar-ruble exchange rate in effect on the day of payment. As noted, dollar denominated loans are commonly used in Russia. The dollar feature has the desirable effect of lowering the initial interest rate and thereby increases the size of the loan for which the borrower can qualify.¹⁸ There are no interest rate or exchange rate caps.

The maximum loan-to-value ratio for a qualifying loan is 70 percent. Minimum loan size is \$5,000 and the maximum loan size is \$70,000--in ruble equivalents. The Agency estimates that the average loan to be purchased will be about \$30,000. Loan term is five to ten years. The Agency enforces an eighteen month lock out period on prepayments. Initially only newly originated loans will be purchased; and, loans will be purchased at par, i.e., the purchase price is the unpaid balance plus any interest charged to the borrower but not yet paid.

Banks are required to use rigorous loan underwriting standards specified by the Agency. For an indefinite period, the Agency will do a secondary underwriting of all loans purchased and return to the originating banks those found not to meet is standards.

Bank payments are on a schedule-schedule basis, i.e., the servicing bank must make up any payment deficiencies on behalf of the borrower when submitting funds to the Agency. Initially, seasoned loans are not eligible for purchase. Loans are purchased at par.

Liabilities

The Agency will initiate operations by purchasing loans using its own capital. However, only \$14 million of the authorized \$80 million Government contribution to equity has been paid in. A small number of loans is being purchased in the first few months of operations so provide time to thoroughly test all systems. Still, with the Agency's business plan projecting funding requirements of about \$90 million during its first twelve months of operation, it will soon fund purchases through borrowed funds.¹⁹

The Agency had planned to borrow in international markets on the strength of its government guarantee. Two reasons contributed to its decision to seek international funding rather than accessing the domestic capital market: the price of international funds is much lower to the Agency,²⁰ and

18. The full interest charge is the dollar interest rate plus the annual percentage change in the exchange rate. If the exchange rate, inflation rate, and income growth move roughly together, the payment to income ratio remain roughly constant over time.

19. The Agency's management preferred not to accept private contributions to its equity--most likely from large banks--until its operations were firmly established in order to avoid the appearance of preferential treatment of the equity holders.

20. The price to the borrower is higher, however, since he/she must in effect purchase dollars with rubles and

international interest rates are dramatically more stable than domestic rates. The more important of the two factors for the Agency's decision was the volatility of Russian rates. Interest rates on longer term debt issues, such as two and three year bonds issued by sub-federal governments, have been substantially more stable, but the variability is still substantial. Volatile interest rate movements result in large month-to-month or quarter-to-quarter changes in borrower payments, and this increases credit risk.

When the market for Russian Debt improves, the Agency will commission a investment banking firm to develop a medium term note program (MTN) under which about \$1 billion in notes will be issued over a three-four year period. The first issue is planned to have a five year term. Interest rates on the bonds will reset semi-annually, and the same interest rate adjustments will be used for the mortgages.²¹

The debt issue will be collateralized by loans purchased with the proceeds. But there is no strict pooling of a group of loans to support a corresponding bond issue. A more definite structure will be developed in the future.²²

Although the germane legislation states that the Government of Russia will provide a full guarantee of the Agency's debt, such a guarantee will not be available in 1998 because guarantee authority was not included in the FY1998 federal budget. (Such authority will be included in 1999.) The Agency has addressed this problem during its start up phase by convincing the City of St. Petersburg, a Subject of the Federation (equivalent to a state in the U.S.) to guarantee an initial loan of \$10 million. Proceeds will be used to purchase loans originated by banks located in the City.

Because of the leadership shown by the City of St. Petersburg, the first two banks from which loans are being purchased are located there: Promstroi Bank of St. Petersburg and Bank St. Petersburg. The Agency will expand its program to other cities when it completes further borrowings.

Russia's financial crisis has delayed the time at which the Agency can go to international market on the strength of a Government of Russia guarantee. Domestic resources are also unavailable. In this circumstance the Agency is seeking direct loans or loan guarantees from international agencies or their executing bodies to obtain "bridge financing". Discussions are proceeding with the IFC and TUSRIF, and they have just begun with OPIC and U.S. investors about the efficacy of OPIC insurance for the availability and price of international funds to the Agency.

Technical Assistance to the Agency

The record of USAID assistance to the Agency falls naturally into three parts: (1) the period before the legal base was finalized in August 1996; (2) the period of intense work between September 1996 and April 1998; and, (3) the time from April 1998 to the end of HSRP in September.

Early activity. The need for a liquidity facility to spur development of the primary residential mortgage market was identified by the HSRP team as early as the beginning of 1993. Project director Struyk and Nadezhda Kosareva began discussing the long range development of the housing finance

therefore pays for increases in the ruble:dollar exchange rate.

21. Under the standard variable rate bond regime, the interest rate in effect for the next six months is set based on LIBOR in effect five working days before the start of the period.
22. There will, however, be segregated of assets and liabilities into homogeneous classes. For example, the assets and liabilities of ruble denominated mortgages will be segregated and managed separately from assets and liabilities associated with dollar denominated mortgages. These might be termed "soft pools."

system with Andrei Vavilov, then First Deputy Minister of Finance. In December 1993 the team took advantage of the opportunity to insert the creation of the Agency in a Presidential Decree on housing finance which the team drafted. For the next two-and-a-half years, the team worked in two directions: first, to educate bankers and officials on the concept and to build support for a secondary facility; and second, to develop and pass the necessary legislation to complete the legal basis for the Agency.

The main written product of this period was a report outlining the structure of the Agency and the legal issues which had to be addressed for it to become an operational reality.²³ This document was key to defining the Agency's operations to Government and Central Bank officials. Urban Institute staff and Steve Butler, the HSRP team lawyer, were the key advisers during this period.

In 1996 Mr. Vavilov and Anvar Shamouzafarov, First Deputy Minister of Construction, saw the Government's new *Svoi Dom* housing program as a possible legislative vehicle for the additional legislation. This tactic proved successful with the purposes, activities, and privileges defined in the *Svoi Dom* acts. In August 1996 a separate Government Resolution was passed defining the Government's contribution to the Agency's capital and naming its board of supervisors. The Board is headed by the Minister of Construction and includes senior representatives of all relevant government agencies and the presidents of four commercial banks.

August 1996 - April 1998. Activity in the first nine months of this period concentrated on the legal work necessary to determine the content of the Agency's charter--necessary for its registration--and the most advantageous legal structure from the perspectives of minimizing its tax liabilities and maximizing its operational efficiency. This effort was led by Mr. Butler, with Russian and American counsel in tax and securities transactions engaged as needed. The work was completed by the summer of 1997, the Government made its initial contribution of 80 billion (old) rubles to the Agency's capital, and the Agency was registered in September 1997.

Parallel with the legal work, action was initiated on defining and detailing the Agency's operations. Fannie Mae, as a subcontractor to the Urban Institute, took the lead here. Two types of activity were involved: short-term missions by Fannie Mae experts to work with Agency staff and IUE housing finance experts assisting the Agency team and a few study visits by Agency staff to Fannie Mae's Washington headquarters for orientation or for more a concentrated set of meetings on a particular topic.

Talbe 5.1 provides summary information on the short-term missions by the Fannie Mae team. These missions were of fundamental importance for the launch of the Agency's operations.

23. S. Butler, N. Kosareva, R. Struyk, and M. Levine, "Proposal for the Russian National Mortgage Agency." (Moscow: Urban Institute Technical Cooperation Office, March 1996).

Table 6.1
Short-term Consultancies by Fannie Mae Experts

<i>topics</i>	<i>number of visits</i>	<i>staff days</i>
policy & procedures; business plan	6	58
information technology	6	57
operations	6	77
financial plan	3	35
risk management; pricing	1	7

The Agency is now substantially capable of proceeding on its own in the areas of policies and procedures, the business plan, the financial plan and operations. On the other hand, further assistance will be needed with IT and risk management and pricing. The Agency is taking steps to secure the necessary help, either from donors or through use of its own resources.

Three study visits were organized under the project.²⁴ Two of these, one each in 1997 and 1998, were one-week general orientation programs. The third was for one Agency staff member who consulted a number of Fannie Mae experts on risk management.

Beyond April 1998. The project's resources for engaging Fannie Mae experts were exhausted by the end of April, although in June-July the Agency contracted for a study tour for its IT team and a visit by an IT expert.²⁵ In response to some evident problems of coordination with the Agency's growing team, by then consisting of five departments, HSRP director, Struyk, was given the responsibility by the Agency's Board of Management to act as an official coordinator from May until the launch of operations in September.

During this period of intense work, the final version of the Lender-Servicer Guidelines was completed, the Agency's initial Business Plan assembled, the legal and operational relationships with the two St. Petersburg pilot banks defined, the basic information technology (IT) architecture for data management established, and plans laid for raising additional funds from the international capital markets and, possibly, multilateral or bilateral donors. Multilateral donors have also been approached about providing additional technical assistance to the Agency during its first year of operation. Much of this work culminated in the Agency's first mortgage purchases in September 1998.

Struyk devoted about half of his time to meeting these responsibilities which included meeting with all departments each week, reviewing their work, making certain each department was informed of other departments' activities, and generally trouble shooting. He prepared agendas for the weekly Agency-

24. The Agency funded a fourth study visit on information technology in July 1998.

25. The Agency is in fairly advanced negotiations with the International Finance Corporation about the Corporation providing further technical assistance to the Agency, possibly in the context of a loan by the IFC to the Agency.

wide coordination meetings which proved essential to moving forward efficiently. Struyk also provided expert advice on certain topics such as pricing the Agency's funds, and participated in negotiations with investment bankers on the structure of Agency borrowings.

Early in this period two of the Agency's most important documents were completed: the Lender-Servicer Guide, which is the "bible" for banks selling loans to the Agency; and, the Business Plan. The former defines *inter alia* the terms of the agreement between the Agency and banks, the loan products to be purchased, the underwriting standards to be used, and the loan commitment process. The latter was very important for orienting investment banks and donor agencies on the Agency's operations.

7. Infrastructure Finance: Long-Term Debt Financing of Capital Investment for Municipal Infrastructure

The Situation in the Summer of 1995 and Project Objectives

When the HSRP-II project started in September 1995, Russian cities were in a severe crisis caused by insufficient financing of capital investment for housing infrastructure. Scanty municipal budgets were unable to satisfy the cities' needs for renovation and development of municipal infrastructure; the proportion of outdated production capacity at utility enterprises was growing, distribution systems were falling into disrepair; the quality and continuity of utility services were going down, while operation costs were rising; deferred costs were accumulating.

Municipalities were well aware that under-funding of capital investment in utilities leads to progressive losses, but the very nature of utility services did not permit substantial reduction of production volume or deferral. The practice of funding capital investments in infrastructure from state and municipal budgets was based on decisions made with a view for short-term results, with no regard to economic efficiency and social justice, thus crowding out more productive investments.

At the same time, the reduction of budgetary sources of capital funds has stimulated reconsideration of the very concept of infrastructure investment and investment priorities, and triggered search for new sources of funds.

This development, however, within the framework of severe macroeconomic conditions and lack of practical experience brought many Russian municipalities and utilities to surrogate schemes of financing infrastructure that look retarded, and economically awkward even if most of them contained some elements of classic financing mechanisms.

Two types of financing practices were being used in Russia at that moment: so-called "housing bonds", and "earning capital" practices.

*housing bonds, generating classical bank loans. Most of housing bonds were structured as a private placements and were nominated in square meters. Those issues were not classic bond issues. They represented a possible way to accumulate money for housing construction and infrastructure development in a period of dramatic housing price rises, but they became completely irrelevant when housing prices stabilized and then declined.

In 1995 housing bond issues in Russia financed housing infrastructure as well as building construction. The cost of building itself varied from 30 up to 60 per cent of total cost, the rest accounted for by the cost of infrastructure (from 70 to 40 per cent, respectively). So, housing bond issues at that moment were a real mechanism to finance housing infrastructure in Russia.

These "traditional" housing bond issues generated (almost inevitably) bank loans for infrastructure and housing. According to the housing bond issue prospectus, municipalities promised investors (people) that each of them would be given an apartment in a year or so once he/she paid for determined number of square meters equal to the size of an apartment. It happened very often that within a year only a small percentage of people could buy sufficient amount of bonds to get a whole apartment. So municipalities usually found themselves without enough resources to complete construction and to pay for infrastructure, but at the same time they were obliged to provide those people who have already paid

100 per cent of the cost (i.e., those who bought enough bonds (sq. meters)) with apartments. In order to accommodate only one family, the municipality had to have the whole building (including infrastructure) constructed (indivisibility problem). To finance the construction with money sufficient only to one or so apartments municipality was forced to borrow. This particular situation generated the necessity for bank loans to cover the costs of building and infrastructure connection fees. The smaller project, in terms of number of buildings, the bigger chance to obtain a bank loan.

The bank loans generated by housing bond issues could be identified as bond (proceeds) anticipation loans. Banks in Moscow (Tokobank, Incombank, Menatep) felt much more secure when they loan money to any municipality who issued housing bonds. In this case bond proceeds served as a relatively reliable source of repayment (or security). The accumulation fund created by municipality to collect proceeds can be recognized as a sort of a cushion (security) for a loan. However, loans generated by housing bonds could cover from 10 per cent to 50 per cent of the total cost of construction and were short-term or medium-term loans (less than a year).

**Earning capital investments on communal payments.* Another approach to finance municipal infrastructure was demonstrated by Moscow housing organizations and the “Vodokanal” Bank. Money for capital investments was being earned by housing organizations on communal payments from population.

Local housing organizations in Moscow collecting payments for water and sewer services used collected money to buy promissory notes of Vodokanal Bank who in its turn promised to pay Water&Sewer company (Moscow Vodokanal) for the service provided to housing organization. For that a local housing organization could have gotten in return from Vodokanal bank of 10 per cent of the sum of the collected proceeds then paid to the bank for its promissory notes. The 10 per cent of the proceeds then were transferred into one of the capital funds of a housing organization. This practice took place every month. A housing organization accumulated resources in its capital accounts and spent them for a selected capital project.

When starting technical assistance to municipalities on infrastructure finance, the team found lack of understanding if not ignorance of the major difference between private and public interests and therefore between private and public finance concepts.

Beyond the questions of prioritizing and valuing projects in Russian municipalities was the perhaps more fundamental concern about the appropriate fundamental character of public investment projects themselves. This issue emerged from inappropriate attempts by some local leaders in Russia to involve their municipalities in profit-making activities. When such endeavors occurred, it is almost as if municipalities themselves were private sector economic actors (seeking to maximize profits in their operations), rather than public sector entities (seeking to provide services to the public that could not properly be provided through the private market). In the form either of municipal lending to profit-making activities or even of municipal equity ownership in private businesses, such public sector involvement in private market activities is almost always an inefficient, unjustifiable, and sometimes irresponsible allocation of public monies to what should be perceived as private purposes.

In one sense, this inappropriate allocation of public monies to private market activities may be seen as a fundamental conflict between a municipality's *objective* in the use of borrowed funds and its *strategy* for doing so.

One type of such an inappropriate municipal investment strategy was the use of proceeds from a municipal bond offering to finance city-owned capital projects for purposes that need not be carried out by the public

sector at all. Another example would be the on-lending of municipal loan funds to profit-making activities that might be partially privately owned. In such instances, the city would be supplanting the function of a private bank. In contrast to the criteria by which capital projects would be evaluated in the public sector, the city's prospective capital projects apparently would presumably be assessed largely on the security of the city's loan to the project (the likelihood that these re-lent funds will be repaid) and on the likely profitability of each project (with perhaps higher re-lending rates imposed upon the presumably more profitable projects). Interest rates to be paid by individual projects might vary, above or below the rate paid by the city, in accordance with criteria to be chosen by the city. Such re-lending activities would involve inappropriately risking public monies for loan repayment in the hope of earning a "spread" between the interest cost of the municipal loan and the interest rate that may be charged to a promising project.

Taking into account the economic environment and infrastructure finance practices that existed at this time in Russia, the HSRP team identified priorities for technical assistance which were consistent with the goals enumerated in successive project workplans:

1. To introduce medium and long-term borrowing schemes for capital investments for urban infrastructure, using payments collected for communal services as a collateral and a source of repayment of the loan.
2. To identify the most promising sectors of housing infrastructure in terms of feasibility of infrastructure finance such as energy-saving projects, gazification projects, in particular: updating boilers to use natural gas, replacement of old energy-intensive water pumps by modern multi-speed models, installation of bio-gas rectification plants with use of the fuel by water utilities to produce electricity and heat at much lower prime cost.
3. To identify several doable infrastructure finance projects in Russian municipalities and stimulate real deals.
4. To create a transparent and rational system of tariff regulations for communal services.
5. To identify various forms of medium and long-term financing urban infrastructure other than borrowing such as leasing arrangements and concession and to stimulate the demand for them from the side of municipalities.
6. To create a facility for municipal and utility creditworthiness analysis and advise on how to borrow for infrastructure finance purposes.

Implementation Strategy

Identifying Types of The Repayment Guarantees Acceptable for Lender. Repayment of funds lent by bank were found to be secured in several forms:

1. securing the loan by project revenues;
2. pledge of financial assets; and
3. pledge of real estate or any other municipal property, if permitted by law;

Most of loans were secured by municipal property. However, actual invocation of the security took a lot of time and money. In addition, finding a liquid collateral was problematic, because many municipalities had either sold (privatized) their commercial assets or wanted to reserve the possibility to

do it. And finally, legal procedures for foreclosure on the mortgaged property were viewed as a complicated and expensive task.

Because of the difficulties of transferring ownership of the mortgaged property from debtor to lender, some banks preferred guarantees in the form of financial assets that were easily realized on the market, other types of financial guarantees and bank deposits as well.

The usage of payments for communal services by the residents as a basic means of securing debt obligations has been introduced by the project. This type of security appeared to be very attractive for several Russian banks (Unexim, MFK-Renaissance, Inkobank, Tokobank, Russian Development Bank) because:

1. Residents' arrears in utility payments are lower compared to that of other user categories;
2. Liquidity of tariffs paid by residents is the highest since the residents pay real money for the utility services, while payments from enterprises and budgetary organizations now are mostly paid in surrogate money or barter.
3. A utility enterprise may pledge its rights to claim communal payments for providing services as a collateral to secure a bank loan (under a contract on pledge of claim).

To guarantee the loan the following steps were to be introduced:

1. The utility enterprise accomplishes the borrowing to realize the resources saving construction and pledges its right of claim to municipal enterprise, following from the contract for services between the enterprise and municipal organization.
2. Only a part of tariffs from residents is pledged. The amount of payments corresponding to the pledged rights of claim, covers as a rule the whole amount of debt, interest on it and the amount equal to non-payments expected.

In addition a part of local budget assets that were used to subsidy utility enterprises and released as a result of energy saving projects can be used as a repayment guarantee.

Identification of Promising Infrastructure Finance Sectors. A large part of utility enterprise costs was found to be attributable to utilities using outdated and economically unsound equipment and losses of water or heat in the distribution system. At the same time, utility enterprises could turn these losses into profits and a source of debt repayment on loans and borrowings specially made for capital investment for renovations.

Economic attractiveness of *energy-saving infrastructure projects* was accounted for by the use of the funds saved by cutting the prime cost of expensive utility services production as sources of repaying the borrowings made for project implementation. The funds gained by reducing the prime cost of utility services production in energy-saving projects can reach 50 per cent at the expense of cuts in losses plus power and energy saving.

The source of debt settlement are cuts in prime cost of utility service production originating as a result of energy-saving renovation. Funds are gained through:

- modern economically sound equipment installation;
- lower losses as a result of renovation;

- cuts in expenses for current repairs of utility enterprises as a result of renovation;
- optimization of the existing equipment;

To allocate and use funds for debt repayment the following should be provided for:

- the level of utility services tariffs collected from the residents should not be changed for the whole investment period. Changes in tariffs may only occur if there are corresponding changes in the cost of resources (water, electricity, fuel) or as an adjustment for inflation. Utility service tariffs collected from residents may rise as a result of utility payments reform, i.e., lower budget subsidies for consumption of the services, or upon termination of cross-subsidizing at the expense of industrial enterprises.
- the former budget subsidies to utility enterprises should be preserved on the same level for the term of debt repayment.

It was demonstrated that renovation of utility enterprises together with employment of progressive technologies and materials lead to essential cuts in prime cost of their production unit even under condition of "inflation expenses"(rise in fuel tariffs, etc.) and thus to reduction of the burden on municipal budgets.

Currently, loans to finance cost-saving technologies are attractive for Russian banks because those projects can be carried out not only by large international and domestic banks, but also by average Russian regional banks. Also, most projects for renovation of municipal infrastructure are dividable, i.e. they can be carried out stage by stage without any damage done to the whole system. Thus the task of capital investment financing can be realized rather quickly.

Gasification projects appeared to be doable because considerable tariff increases are possible, since the share of gas users fees was only 5 per cent of average family total communal payments. So a 20 per cent tariff increase could result in only 1 per cent increase of the total volume of a family communal payments. This gave some space for tariff adjustments related to debt repayment of which most other communal services were and still are deprived.

The proposed scheme was used for the gasification project in the city of Sudogda (Vladimir oblast), with further debt repayment from the funds saved due to cuts in prime cost of utility services (hot water, heat) and natural gas supply to the population.

The project suggested connecting the main gas pipeline and necessary gas branches to the power stations in residential districts generating heat and other consumers. The parties involved in the project were:

- regional administration;
- local administration;
- municipal enterprise collecting utility payments;
- gas suppliers;
- an organization constructing the gas pipeline.

Major pre- conditions:

1. Sources of loan repayment. The tariffs collected from residents are used as a main source of loan repayment because to-day residents are the only service consumers who pay real money, rather than money surrogates. The latter as a rule cannot be used for loan repayment. Another source of repayment

are regional and local budget subsidies.

2. *Preservation of utility services tariffs and budgetary subsidies at the same level.* It was proposed that the level of utility services charges collected from residents and the amount of budgetary subsidies to utility enterprises realizing the project be preserved for the whole term of loan repayment.²⁶ Assets are accumulated in a special loan redemption fund.

Financing the gasification project with a bank loan called for special attention to the forms of loan repayment guarantees. Loan repayment guarantees were offered in the form of:

- regional budget guarantees;
- pledge of regional budget promissory note²⁷,
- support of minimum balance on the account of redemption fund,
- opening an account of the redemption fund in the lending bank,
- pledging rights of claim to utility payments, and
- risk insurance from an insurance company paid by the enterprise.

Work with Federal Authorities. The infrastructure finance group took active part in development of the financial and economic concept of energy and resource saving in Russia prepared by the State Committee on housing construction (now the RF Ministry for land policy, construction and housing communal economy – Minzemstroi).

The concept developed independently by Minzemstroi was not accepted by the meeting of the governmental commission on the housing communal reform. Revision of the economic part of the concept in accordance with the project materials on infrastructure finance projects was named as a mandatory condition for acceptance of the concept. Having been revised by the project experts, the concept was finally approved.

In the field of infrastructure finance, the reputation of the HSRP-IUE team with federal authorities has been built by infrastructure finance specialists taking part in the work of Research Council on the Housing Communal Reform under Minzemstroi of Russia. IUE experts took part in number of seminars organized by the Council.

Work with Banks. Project specialists trained specialist of a number of Russian banks in long-term lending to municipal enterprises. Schemes were worked out on debt financing of reconstruction and development projects of water, heat and gas suppliers. A packet of documents on execution of such transactions was produced.

A scheme involving pledge on rights of claim to utility payments to secure loans has been developed for RF Sberbank. Legal documents for such transactions have been provided. Preparation of a number of loan contracts using this scheme are in progress.

Consultations have been provided to specialists of the St.Petersburg Bank for Reconstruction and

²⁶ Tariffs may be changed only to reflect changes in cost of resources (water, electricity, fuel) and as a result of inflation.

²⁷ Federal law of 03.11.97 “ On promissory notes and bills of exchange” allows the administrations of municipal entities and subjects of Russian federation to pledge themselves on promissory notes and bills of exchange only in cases specially stipulated by the federal law. There is no such a law at present , but this possibility cannot be excluded in future.

Development on issue of bonds secured by profit from infrastructure projects. By summer 1998 work was in progress on preparation of issue prospectuses for two cities of the Leningrad Oblast. Negotiations with the leadership of “Inkombank” commercial bank were ongoing. The participants agreed to contract with IUE experts to prepare municipal infrastructure finance projects. It is expected that IUE experts will participate in training of city administration officials in investment projects development on the “Inkombank” base.

Risk analysis was performed for the pilot loan of the Novgorod Oblast administration. The bond issue was placed on conditions similar to Moscow (City) borrowings. It is planned to use a portion of receipts from placement of the next issue for financing of infrastructure projects.

Work with Utilities’ Capital Equipment Suppliers. Capital equipment suppliers were recognized as one of the major engines for introduction of infrastructure finance schemes in Russian municipalities.

IUE has entered into a cooperation agreement with the Research-Production Union “Stroypolimer”. This enterprise trains experts in progressive programs in the field of water supply. Joint seminars are held for city administrations and heads of municipal water supply enterprises. In these seminars the IUE experts lecture on issues of organization of non - budget financing of projects for modernization of water supply systems. Seminars have already been held in Astrakhan, Moscow, Ivanovo, Tverskaya oblast.

A joint IUE-Stroypolimer booklet “Additional Sources of Financing of Reconstruction and Development of Utility Objects in Russia” was prepared. (Where reconstruction of distributions lines for communal purposes was taken as a model). Study of this booklet is recommended for city administrations and subjects of the Russian Federation by the RF Ministry on Housing, Construction and Housing Communal.

Work with Utilities. *Heat Supply.* IUE has entered into an agreement with the company “Elektrotehnoservis” (Vladimir) on comprehensive examination of municipal communal services enterprises. “Elektrotehnoservis” assesses the technical condition of equipment and develops a package of recommendations for implementation of resource saving. IUE staff carries out financial expertise of the project and develops recommendations for financing of modernization. A contract for examination of heating network in the city of Neringri is awaiting signing.

“Elektrotehnoservis” has already examined the heating nets in the city of Volgograd is preparing financial analysis.

Water and Sewer. A comprehensive analysis of the Vodokanal in the city of Rusayevka (Mordovia) was done. The RPU “Stroypolimer” examined its technical side, while IUE assessed the produced results from the point of view of economy. The results served as a foundation for an investment project. The implementation of the project stimulated interest by a number of Russian banks.

A similar project for the city Novgorod Veliky is moving through the preparation stage. In other actions, IUE staff took part in seminars sponsored by the Association of Water and Water Waste Enterprises. IUE’s contribution was on issues of debt financing and tariff policy. Seminars were held in Sochi and Moscow.

Work with New Forms of Financing Urban Infrastructure Development. When long-term

borrowing schemes are too costly and too sophisticated for stand-alone utilities and at the same time privatization of utilities turns out to be too costly for citizens, a long-term concession arrangement is a good compromise. The cost of capital reconstruction of utilities can be reduced by leasing arrangements that allows the utility to be exempt from enterprise property tax.

Concessions. IUE specialists have been actively working to promote use of delegated management mechanisms in the housing communal sector. Work has been carried out on attraction of foreign concessionaires to the Russian cities. Consultations were provided to municipal administrations on organizational schemes in working with the concessionaires. And the project has acted as a bridge to introduce cities to potential concessionaires.

Regular discussions have been held with representatives of several French companies looking for concessions in water sector in Russia such as Generale Des Eaux, Saur International, Schlumberge. In addition a special selection of Russian cities ready for concessions has been performed by IUE-IF group. At this time, negotiations with concessionaire companies on concessions in water sector are in progress in several cities (Chernogolovka, Rzhev, Podolsk, Arkhangelsk). Moscow Vodokanal is also planning to transfer into concession newly constructed water purification plants in Southern Butovo. IUE held seminars on concession arrangements in several cities, including St.Petersburg, Vladivostok, Moscow, Astrakhan, and others.

Leasing. IUE has promoted leasing in projects dealing with infrastructure. Seminars devoted to this subject were held in St. Petersburg, Sochi, and Moscow. On IUE's initiative the leasing company "Income - leasing" started a project for lending to municipal utility enterprises based on a leasing scheme. The IUE organized schemes for interaction with the city administration, assessed financial condition of the municipal enterprises, made estimates for the projects, and developed loan security packages.

To date work on preparation of a project for lending for heating network modernization in the city of Volgograd is under way. The total volume of the deal will be about USD 10 million. The first stage will account for 1.2 million US dollars. The IUE is doing financial assessment of the project and is developing a loan security package for the city administration.

Tariff reform. One topic deserving special attention is tariff reform, which is easily modeled in the financial analysis package developed by the project.

Tariff reform is justifiable from the perspective of both current expenditures and capital expenditures. In terms of current expenditures, many communal services in Russian municipalities are presently recovering no more than 30 per cent of their reported operating costs. So as to reduce this burden on municipal budgets, it is therefore desirable to consider tariff rationalization and increases, if needed, that would improve the overall level of operating cost recovery. In terms of capital expenditures, moreover, it is reasonable that future consumers of long-term project benefits would also contribute commensurately to paying the costs of the project that provided them with such benefits in the first place.

Infrastructure finance team found great interest in tariff rationalization programs from number of private companies, such as Stroipolimer and Finecos, supplying plastic pipes and other water&sewer equipment for utilities to help them reduce leakage and save power, and from banks side as well (Unexim, MFK-Renaissance, Russian Development Bank, St.Petersburg Bank for Reconstruction and Development). Those companies are expected to be major engine of distribution of tariff reform and long-term financing concept. They are strongly motivated because tariff reform is the *sine qua non* for most investors.

Work with Association of Mining Towns. By the request of the Association of Mining Towns,²⁸ the project developed the conceptual framework for creation of a guarantee fund for investments in mining towns infrastructure. The Fund is envisaged as a non-governmental non-profit organization with the principal task of providing guarantees for the loans taken for reconstruction and development of this infrastructure. By the summer of 1998, negotiations on World Bank support for this measure have come out of a dead end; and they are actually making good progress. Active discussion of the proposed concept was ongoing.

Also by the request of Association of Mining Towns the project has developed criteria for analysis and selection of municipal infrastructure investment projects. The cities are now in the process of preparing the projects for consideration of investors.

Regional Project Dimensions

In Year One of the project the work was focused on financial analysis for projects in the City of Nizhny Novgorod, the City of Pskov, Sudogda (Vladimir Oblast). (Table 7.1 gives a summary of projects which have reached an advanced stage.)

²⁸Budgets of municipalities formed on the basis of mining companies are in a very grave state. At present, coal mines are in a state of deep crisis for lack of funds to modernize their equipment. The price of Russian coal is much higher than that of foreign producers.

The International Bank for Reconstruction and Development is considering release of the second tranche of the coal mining restructurization loan. The loaned funds are planned for investment into the infrastructure of mining towns. The loan was under question because the IBRD lacked assurance about compliance with the designated purpose of the loan.

Table 7.1
Infrastructure Finance Projects
Housing Sector Reform Project, 1996-1998

<i>location</i>	<i>type of project</i>	<i>status as of 8/98</i>
Sudogda Vladimir Oblast	long-term finance scheme for gasification project	project is underway
Nizhni Novgorod #1	long-term finance scheme for housing infrastructure (water & sewer and heating) development in downtown slum area targeted for redevelopment	project is underway; part of finance should come from EBRD loan
Nizhni Novgorod #2	long-term finance scheme for construction of two ozonation stations	Eurobond financing secured
Ryazan	long-term finance scheme for water pipeline relining project	project being financed on a pay-as-you-go basis
Ruzaevka Republic of Mordovia	long-term finance scheme for water pipeline relining project	financed through bank loan
Volgograd	long-term leasing scheme for capital equipment purchase for local utilities	financed by Inkom-Leasing
Dzerjinsky #1 Moscow Oblast	concept of medium-term financing through commodity loan (purchase of capital equipment with repayment in installments) for water purification station	project completed
Dzerjinsky #2 Moscow Oblast	concept of municipal bond issue for long-term financing of housing infrastructure	bond prospectus to be registered in 9/98
Gus-Khrustalny Vladimir Oblast	introduction of tariff regulation mechanism	project is underway
Uglich Yaroslavskaya Oblast	introduction of tariff regulation mechanism	project is underway
Nadym Tyumen Oblast	introduction of tariff regulation mechanism	project is underway

In Year Two the activities of infrastructure finance team became less educational and more practical. Two projects were considered closer to implementation: (1) a long-term loan to bring natural gas to the Sudogda administrative raion of Vladimir Oblast and (2) a long term loan for housing infrastructure in Nizhny Novgorod as part of the City's program of replacing dilapidated buildings in the downtown area.

The Sudogda gasification project consisted of financing construction of gas pipelines and boilers, financed with a bank loan repaid through the Gasification Fund (Repayment Fund). Along with contributions from the oblast and raion administrations, this fund was also supposed to receive a specified share of the residents' payments for natural gas. Therefore, the fund would have three main sources: Vladimir Oblast budget; Sudogda Raion budget; 14,5 per cent of payments collected from the oblast population for central gas supply.

As was already mentioned the gasification project was chosen because tariff increase was affordable for population. Although officially approved by Vladimir Oblast and Sudogda Raion officials, the project has not been implemented yet because of Gazprom offered to implement the project with "free" federal budget money. However, no federal financing has yet been provided. So the Sudogda Raion Administration still keeps the whole financing scheme of the proposed project in mind, using some of its elements in mind.

A package of materials (financing schemes and documents needed for their implementation) based on Sudogda gasification case presenting long-term approaches to financing infrastructure projects was submitted to the Federal Recommendations for the Housing and Utilities Reform. That package has also been adjusted for the specifics of water & sewer projects and is of great interest for municipalities and construction companies doing infrastructure works.

Based on that package and know-how acquired at the seminar on infrastructure finance given in Irkutsk, the Mortgage Branch of East Siberian Commercial Bank was trying to organize a pilot (0,3 - 0,5 bln old rub.) loan to Irkutsk Vodokanal for a period of more than 1 year, at a 10-15 per cent annual interest rate with a part of Vodokanal revenue stream pledged as a security for a loan. The gubernatorial election in Irkutsk oblast postponed the realization of the project.

The infrastructure finance team performed a preliminary financial analysis for infrastructure loan as a part of reconstruction project in the downtown area of Nizhny Novgorod. The project entailed tearing down dilapidated buildings, resetting 1,856 permanent residents from 10 separate blocks and leasing out vacated land plots for their reconfiguration, improvement and development. The City intended to obtain a loan from the oblast, which in its turn, was planning a Eurobond issue, or financing from the IBRD. The Oblast Administration is supposed to use the proceeds from bond sales to make loans, including the one to Nizhny Novgorod for its reconstruction projects.

To analyze the various options for structuring the financial obligations (i.e. the annual loan repayment to the Oblast), the infrastructure finance team developed a methodology that allowed it to specify parameters, such as those proposed by the Administration's preliminary project financing plans. With this methodology the team also created several scenarios by varying factors that could have a negative impact on the project (e.g., inflation, a drop in interest in land auctions). The report on this analysis was accepted by the Nizhny Novgorod Administration as a possible guideline in implementing the project and started to be implemented.

Since Nizhny Novgorod Oblast has already got credit rating from Moody's and Standard&Poors, and placement of the Eurobonds happened (March, 1997), the realization of the project is expected to happen soon. Recent Mayorial elections that were recognized by federal electoral commission as illegal brought most borrowing (especially international) projects to halt. After next round of elections expected in September 1998, the project may return to normal.

During the project the infrastructure finance team found a number of regions and municipalities (Novgorod oblast, the City of Novgorod, Rostov oblast, the City of Rostov, the City of Dzerzhinsky

(Moscow Oblast), the city of Volgograd) which are developing borrowing programs for future capital investments including housing infrastructure. Most of those regions and municipalities realize the necessity of long-term financing mechanisms for building housing infrastructure. As a first step toward that the goal Novgorod Oblast Administration with the assistance of infrastructure finance team and Russian Development Bank developed a concept of the oblast borrowing program in which the first phase 30 bln (old) rub. 6 month GO-type Novgorod Oblast Bond Issue is to create good credit history before implementing second phase -- a 300 bln. rub. 3 year Revenue Bond Issue for infrastructure development in the City of Novgorod. The concept was approved by Novgorod Oblast Administration. NOBI was placed in MICEX in March, 1998.

The project also expanded its infrastructure finance activities to the related fields. A member of infrastructure finance team participated at the initial stage in the working group established by Moscow Committee on Municipal Loans to Moscow to develop a capital budget concept for the city. Infrastructure finance team organized Joint Infrastructure finance seminar with Russian Regional Development Bank on various forms of financing urban infrastructure such as bank loans, municipal bonds, concession, leasing arrangements, service contracts. The issue of privatization of urban utilities has also been raised.

The team also made creditworthiness analysis of the City of Novgorod Administration, Novgorod Oblast Administration and the city of Dzerjinsky Administration and advised those administrations on how much they can borrow and on the structures of proposed loans. Technical assistance on proposed housing loan was provided for the City of Rostov administration.

Evaluation of over fifteen infrastructure projects have been done: 7 -- in Pskov, 2 -- in Nizhny Novgorod, 1 -- in Sudogda (Vladimir oblast), 1 -- in Rusaevka (Republic of Mordovia), 2 -- in Selyatino (Moscow oblast), 1 -- in Ivanovo, 1 -- in Volgograd., 1 -- in Dzerjinski (Moscow oblast)

The intensive efforts have been made for the passed year in conducting regular infrastructure finance seminars in Vladivostok, Irkutsk, Rostov, St. Petersburg and presentations of infrastructure finance program in Nizhny Novgorod, Ulianovsk, Perm, Dzerjinsky, Samara, Saratov, Orel, Novgorod.

Materials prepared by infrastructure finance team suited to instructing municipal officials on infrastructure finance such as "Legal Aspects of Taxation of Municipal Bonds", "Guidelines on long-term infrastructure finance in Russia", and a "How to" manual on Long-Term Financing of Gazification Project were widely distributed.

Our own financial analysis package offers a wide range of alternatives from which to choose in structuring a prospective project loan. It was specifically designed on an Excel spreadsheet for this particular infrastructure finance application, and we have modified and improved the package as we have learned more about the borrowing needs of Russian municipalities.

Developments to the End of the Project and Future Aspects

New developments. Most of above mentioned negative factors present at the start of the project are still in place. However, the very concept of infrastructure finance among Russian municipalities underwent serious revisions.

Several major reasons influenced those revisions

(1) Improved macroeconomic conditions. Since the start of the project macroeconomic conditions that

are critical for long-term infrastructure projects continued to improve²⁹. Short term GKO yield has dropped down from about 170 per cent in October 1995 to 16.02 per cent in March, 1998 following the inflation rate decline from 131,4 per cent in 1995 down to about 12 per cent in 1998. Estimated interest rate on commercial bank loans for 1 and more years dropped to about 27 per cent (refinancing rate – 21 per cent +3 per cent (December, 1997); 7 per cent – 15 per cent on paper loans). Competition among banks for lending funds to municipalities and to municipal enterprises increased dramatically since September 1995. A final important factor: many large and medium-size municipalities experienced modest economic growth.

(2)Legal environment for the long-term financing became clearer with the adoption of the federal laws on Securities Market, on Financial Fundamentals of Local Self-Government, and finally, in general, the Budgetary Code (August, 1998 in the Presidential Office for final approval).

(3)Dramatic increase in interest in long-term financing of housing infrastructure. Many municipalities in Russia by the summer of 1998 have realized the necessity of undertaking modest borrowing for reconstruction of existing infrastructure and development of new infrastructure projects. Strong influence on them is being exerted by private companies operating in housing infrastructure equipment sector. The growing number of companies stimulating demand for municipalities' ability to pay for infrastructure works is one of the most important indicators of the positive changes in the infrastructure finance sector. On the lender's side there are also good indications of interest in infrastructure projects: one of the most remarkable recent deals was a EBRD 127 mln DM loan to St. Petersburg Vodokanal (Water&Sewer company) for 10 years with interest rate LIBOR + 3,75 per cent, 4-year grace period. Domestic lenders still provide only short-term loans to utilities.

Prospects. *Likely greater demand in Russia for infrastructure capital financing after macroeconomic stabilization (after fiscal crisis of April – August, 1998).* During the second year of the project regional electoral campaigns appeared to be the major constraint for new long-term financing initiatives. Several projects were delayed: Sudogda gasification project in Vladimir oblast, pilot bank loan in Irkutsk, most of former projects in Ryazan, etc. By the summer 1997 governor's and mayor's elections were conducted in most Russian regions and cities. This factor is very important incentive for new medium and long-term initiatives in the housing infrastructure sector.

Expansion of borrowing through issuing Eurobonds. Eurobonds have recently attracted considerable interest in Russia as a potential source of public financing. In a subscription that more than doubled initial expectations, the Russian Federation issued \$1 billion in Eurobonds in November 1996, with an interest rate of 9.25 per cent, only 3.45 per cent over that of U.S. Treasury securities. Municipal Eurobonds were also a great success during late 1996–1997. The City of Moscow placed \$0.5 bln issue with the same interest as Russian bonds. Buoyed by these results, St. Petersburg placed \$300 million on the Eurobond market. Nizhni Novgorod Oblast placed Eurobonds for \$100 mln. Other regions, including Ekaterinburg Oblast, Komi Republic, Samara oblast, Krasnoyarsk krai and many others are also looking to the Eurobond market as a source of multi-year capital financing on generally favorable terms, however federal authorities tend to impose severe limits over foreign regional debt.

Despite these high expectations, only the larger Russian municipalities are likely to successfully acquire substantial amounts of capital through Euroborrowing during the coming months. And federal restrictions may even interfere with these plans. In the near term, the needed assurance of repayment is likely to discourage investors from all but the larger cities and some other Subjects of Federation, whose name recognition, prominent size, and previous borrowing experience can be of significant value in attracting capital in this

²⁹ until recent fiscal crisis in April-July 1998.

way. The larger and better-known cities may be capable of attracting some international funds because of their greater exposure to international business and their growing attractiveness as markets for foreign products and services, and as sites for foreign investment. Most Russian other cities, however, are probably not yet ready to seek longer-term loans from international private sources on a significant scale.

Any Russian municipality that may contemplate the Eurobond market should first consider some of the practical approaches to multi-year municipal borrowing that are discussed in this Chapter. These approaches should include preparation of realistic capital improvement programming of feasible projects; identification of sufficient project-related revenues to assure timely loan repayment; and preparation of good documentation on the proposed project, loan repayment prospects, and municipal credit history. Indeed, even so well-known jurisdiction as the City of St. Petersburg is presently seeking to improve its attractiveness in Western capital markets by (a) better organizing and understanding its overall debt burden, (b) arranging for an international-standard audit of the City's finances, and (c) seeking to make the City's budget more transparent.

Tariff regulations become to be seen by investors as critical measure to secure investments (loans) in utilities and other municipal enterprises and or in municipality itself.

8. Small Grants Program

Background

By the start of HSRP II, the Urban Institute and USAID had identified a small but growing number of private voluntary organizations (PVOs) and non-governmental organizations (NGOs) working throughout the housing sector in Russia. Direct assistance received through USAID's HSRP provided many of these NGOs with the expertise and techniques necessary to operate in and assist the development of their local housing sectors. Unfortunately, the economic conditions in the country over the last several years presented significant difficulties for many of these NGOs. The Small Grants Program of HSRP II was established to support the institutionalization of housing sector reform by funding primarily non-governmental organizations working in the housing sector. The goals of the grants program were to promote the institutionalization of housing reform by helping such organizations become self-sustainable through long-term revenue generating activities.

Work Completed

In the spring of 1996, UI conducted the first small grants competition and awarded ten grants to housing sector NGOs. In the second and third rounds, conducted in 1997 and 1998 respectively, 18 more grant applications were approved. In all three rounds UI dispersed \$ 224,734 to 28 grantees.

Table 8.1

	<i>No. of applicants</i>	<i>No. approved</i>	<i>Ave. Amount (\$) of Grant</i>	<i>Total Amount (\$)</i>
Round 1 (1996)	21	10	\$ 3,612	\$ 36,119
Round 2 (1997)	27	8	\$ 7,759	\$ 62,070
Round 3 (1998)	29	10	\$ 12,655	\$ 126,545
Total	77	28	\$ 8,026	\$ 224,734

The geographical distribution of the grants was also very wide. Examples include Moscow, Arkhangelsk, Yaroslavl, Ekaterinburg, Novocherkassk, and Kansk (see Figure 8.1). For a description of organizations, amounts awarded and tasks accomplished, please refer to Table 8.2.

Potential applicants were located and informed about the grants competitions in several ways. Because of its extensive work throughout Russia, the UI Regional Team maintained contacts with dozens of developing NGOs in the housing sector. Lists of names and organizations also were obtained from USAID and from a USAID-sponsored housing sector NGO conference held in St. Petersburg in 1996. Announcements of each competition were distributed widely throughout Russia via telephone, fax, electronic mail and direct contacts. Competition announcements were also given to other grant-making organizations such as the Eurasia Foundation and the Ford Foundation for further distribution.

The competitions were open to all Russian NGOs working in the field of housing reform. Preference was given, however, to those NGOs whose staff or board members had a proven track record of work in the housing sector or had been directly involved in USAID's Housing Sector Reform Project, either as staff or as technical assistance recipients. In each round, applicants were encouraged to submit proposals not exceeding ten pages, in which the applicant described: the history and experience of the organization; the feasibility and applicability of the proposed project; expected results; and how grant resources were to be used to make the organization more self-sufficient.

All projects were then reviewed by a commission consisting of representatives of UI, USAID and CHF (the Cooperative Housing Foundation). The proposals were evaluated according to a scoring system whereby those with the highest marks qualified to receive grant funds. Proposals were evaluated on the following criteria:

- project impact on housing sector reform;
- direct relationship between the proposed project and organizational sustainability;
- proven experience of the staff and the organization;
- the level of development of cooperation and collaboration with similar organizations;
- potential for the organization to attract additional funding; and
- overall quality and presentation of the proposal.

Results

All three rounds of the HSRP small grants program were a success. The program has met or exceeded the goals established by USAID and the Urban Institute by:

- increasing the number of citizen advisory groups working with local governments by assisting with the drafting and implementation of housing sector legislation;

- increasing the level of activity and number of NGOs throughout Russia;
- assisting NGOs to become financially self-sustainable;
- increasing coordination among housing sector advocacy groups and NGOs;
- increasing the number and quality of training courses offered to tenant groups and condominium managers;
- providing consulting services to and disseminating reform-oriented information among building residents; and
- increasing the level of professionalism of NGO staff along with the reputation of the NGOs themselves.

UI has monitored the implementation of the grant projects and the impact each has had on the local housing sector. In Barnaul, for example, the Altai Condominium Center invited over 200 unemployed people to participate in condominium management seminars. The result has been employment for more than 152 people, improved management for the growing number of homeowner associations in the city, as well as a greater understanding of issues related to the housing sector. In Vladimir, Condominium No. 1 developed a package of financial and accounting software specific to the problems and legal issues of homeowners associations. This package of software was offered free of charge to other homeowner associations throughout Russia. Other NGOs, such as Dialogue in Novgorod and the Moscow Housing Association, used grant funds to establish consulting and training centers where services are now offered on a fee basis. These are only a few of the many positive programs that were developed with funds provided under the small grants program.

Overall, HSRP's Small Grants Program has provided funds necessary for NGOs to offer training to condominium managers, seminars for government officials and homeowner associations, consultations to hundreds of tenants, dissemination of important housing sector-related information, and expanded services to NGO members and average Russian citizens. Assistance provided in the form of small grants under HSRP has helped to ensure that those NGOs with the best ideas and management skills will survive and offer the kind of assistance and citizen-government interaction witnessed to date.

Table 8.2
Summary Information on the Small Grants Program

<i>No.</i>	<i>Name of Grantee</i>	<i>City</i>	<i>Project</i>	<i>Amount Awarded</i>	<i>Accomplished</i>
Round 1 - 1996					
1	Public Center for the Support of Housing Sector Reforms, President: Nina Stankus	Novosibirsk	Technical support for training programs promoting housing sector reforms	\$ 2,000	- television and video equipment purchased - training courses conducted on new forms of management and maintenance of housing - dissemination of existing Russian experience gained from HSRP
2	Moscow Union of Housing Owners in Municipal, Co-op and Departmental Housing Stock, President: German Lomtev	Moscow	Support for the Institutionalization of Housing Sector Reform	\$ 6,000	- funds to pay salaries of personnel, lecturers, and trainers - computer, fax and Xerox purchased - methodology and informational support developed to assist condo associations - consultations and training provided to tenant groups and managers
3	Tver Association of Housing Associations (AZhT), President: Ilya Dunaevski	Tver	Housing Associations Dissemination Project	\$ 6,000	- work with local Fund to place water/ heat meters in buildings. - held 1 seminar on housing reform - work with city дума on draft laws, regulations related to condo registration. - provide legal and tech. assistance to homeowner associations.
4	All National Fund for Decent and Affordable Housing, President: Anatoly	Moscow	Systemization and Streamlining of Public Consultations	\$ 5,992	- equipment purchased with grant funds and used with another USAID grant to create study center for training tenants. - specialists were hired to provide consulting to more than 300 citizens of Moscow and other Russian cities.

	Basargin				
5	Urals Regional Association of Housing Owners, President: Natalya Kovaleva	Ekaterinburg	Publication of Newsletter "Tovarishество"	\$ 5,827	- successfully published and distributed 6 issues of the "Tovarishество" newsletter to over 600 people throughout Urals region - topics of newsletter included analysis of housing legislation, training, homeowners associations and letters from members
6	Partnership of Housing Associations of Arkhangelsk, President: Sergey Fedorov	Arkhangelsk	"To Achieve Understanding". To extend the analytical, informational, lobbying and training capabilities of the organization.	\$ 1,500	- creation of Partnership finalized, staff hired - computer equipment purchased - consultations with tenant groups - training courses for activists and managers - dissemination of info in local and regional press
7	Moscow Union of Housing and House Construction Co-ops and other Commercial Autonomous Housing Associations, President: Valentin Grigoriev	Moscow	To extend the analytical, informational, lobbying and training capabilities of the organization.	\$ 1,750	- grant used to purchase office equipment, including a computer, printer, fax and Xerox - data base created in support of organization members - development of financial and economic regulations for housing cooperatives
8	Moscow Housing Association, President: Vladimir Kuznetsov	Moscow	Establishment of Information, Analytical and Consulting Center	\$ 2,050	- center was successfully established. - grant funds for purchase office equip. - center is working towards condo creation, work with tenant groups, creating data base of condos, training and dissemination of experience of condo creation and management

9	Public Center for the Support of Housing Sector Reforms, President: Nina Stankus	Novosibirsk	A Market Study to Support Housing Sector Reform Activities; Development of a Business Plan	\$ 1,000	- funds used for salaries for management-consultant services - survey of local demand and audit performed - business plan created to expand membership and create market for services
10	Urals Regional Association of Housing Owners, President: Natalya Kovaleva	Ekaterinburg	Publicity Campaign and Membership Drive Proposal	\$ 4,000	- Association grown to over 100 members, incl. homeowner associations, board members, developers, builders, enterprises, local officials - promotional brochure printed - three seminars conducted - free consultations provided to initiative groups

TOTAL \$ 36,119

Round 2 - 1997

1	Interregional Organization of Unions of Homeowners, President: German Lomtev, Lidiya Grechuhina	Moscow	Creation of an interregional system of information on questions regarding the foundation of homeowners associations and economic-finance activity in Russia	\$ 8,000	- grant funds for purchase of office equipment and fax-modems - modems will be to create e-mail capability among organization members - e-mail will be used to spread information and consultation on homeowner associations throughout Russia to members
2	Nizhny Novgorod Department of the Society of Russian Construction Engineers, President: Vataliy Frolov	Nizhny Novgorod	To render assistance to oblast and rayon administrations in housing sphere market reforms by providing training, consulting and exhibiting services	\$ 9,000	- grant funds for purchase of computers, Xerox, and software - Information Center will be established and be available to housing groups and tenants of Nizhni Novgorod - exhibitions and training will be available for city administration and housing groups

3	Partnership of Housing Associations of Arkhangelsk, President: Sergei Fedorov	Arkhangelsk	Creation of a service-information center on questions related to Arkhangelsk oblast housing policies	\$ 8,100	- grant funds to be used for purchase of Xerox, modem, and creation of legal data base - seminars and consultations will be held for initiative groups and homeowner associations - bulletins will be printed and distributed
4	Research Institute "Dialogue", President: Alexander Zhukovskiy	Novgorod	Development of a system for training homeowner association managers	\$ 8,500	- grant funds to be used for salaries and purchase of office equipment - a system of training of homeowner association managers will be created and carried out
5	Altai Condominium Center, President: Olga Glushkova	Baranul	Training for 240 unemployed persons to become condominium managers. 12 training courses for 15 days; 20 persons in each group.	\$ 8,000	- grant funds to be used for staff salaries and purchase of small office equipment - 240 currently unemployed persons will be trained as condominium managers during 12 seminars/courses
6	Tver Association of Housing Associations, President: Ilya Dunaevski	Tver	Legal and informational support to homeowner associations and building co-ops, including a credit mechanism for housing associations.	\$ 9,000	- grant funds to be used for staff salary (part time), purchase of Xerox machine, development of software, and office equipment - assistance will be provided in creation of a customer service organization in Tver - consultations with HOAs
7	Urals Regional Association of Housing Owners, President: Natalya Kovaleva	Ekaterinburg	Continued publication of the newsletter "Tovarishstvo", five issues	\$ 9,000	- grant funds to be used for staff salary for editor, journalist, and assistant - grant funds to be used to purchase one additional printer - 5 newsletter will be published
8	Condominium No. 1, President: German Morozov	Vladimir	Developing accounting and financial assistancy software for condominiums	\$ 2,470	- computer equipment and Xerox will be purchased - equipment will be used to proved accounting and other financial assistance to homeowner associations - experience will be disseminated

TOTAL \$ 62,070

Round 3 - 1998

1	Union of Homeowners	Cherepovets	"New City"	\$ 15,000	<ul style="list-style-type: none"> - Training for condo chairmen, managers and accountants - Creation of a condo consulting center - Purchase of 2 computers, software, printer, copier, fax
2	Altai Condominium Center	Barnaul	Housing Sector Reform Project: Introducing Housing Maintenance on a Competitive Basis	\$ 9,000	<ul style="list-style-type: none"> - Holding a maintenance competition in one city district and analyzing the results - Purchase of copier, computer, printer
3	Russian Building Engineers Society	Nizhny Novgorod	Programs and Periphery for Computer Fulfillment of Resource Saving Projects and for Information Provision for Housing Reform	\$ 12,000	<ul style="list-style-type: none"> - Purchasing and installation of building design evaluation software - Installation of software, purchase of a plotter - Staff training on new software, and analysis of building design for efficiency purposes
4	Homeowner's Partnership "Krasny Bor"	Yaroslavl	Addressing Some Problems of the Development of Homeowner Partnerships	\$ 9,000	<ul style="list-style-type: none"> - Research on condo management and ways to increase condo sustainability - Purchase of office equipment - Training for staff members
5	Inter-Regional Consulting & Methodological Center	Novocherkassk	Development of a System of Preparation of Managers of Homeowners Associations	\$ 15,000	<ul style="list-style-type: none"> - Preparation and printing of training manuals - Training of managers for condo associations and prep. of data base of managers - Purchase of office equipment
6	Partnership "Housing Sector Support"	Yekaterinburg	Information Support of the Program of Reforming the Housing Sphere of the Urals Region	\$ 9,000	<ul style="list-style-type: none"> - Producing monthly bulletin on housing reform-related issues (6 bulletins) - Distribution of bulletins - Purchasing a personal computer
7	Public Center of Assistance to Homeowner Partnership	Gus-Khrustalny	Assistance to Home Owners Associations	\$ 16,000	<ul style="list-style-type: none"> - Creation of a centralized Accounting Center for home owners associations - Creation and implementation of resource-saving technologies in condominiums - Training for condominium staff trainers - Developing software for the accounting center

8	Scientific-Educational Org. "Dialog"	Novgorod	Development of a system of preparation of the managers of homeowners associations	\$ 17,545	<ul style="list-style-type: none"> - Preparation and printing of training manuals - Increase qualification of trainers - Training of managers throughout NW Russia - Purchase of office equipment
9	Scientific Firm "Zhilische"	Moscow	Information support for housing economy reform implementation	\$ 16,000	<ul style="list-style-type: none"> - Introducing TV program on housing issues, script writing, filming - Designing, printing and distributing posters on housing reforms
10	Orpheus Company of Homeowners	Kansk	Condominium resource-saving, and energy efficiency analysis	\$ 8,000	<ul style="list-style-type: none"> - Installation of heat and water meters - Preparing analysis on increasing condo efficiency and sustainability - Meter maintenance - Purchase of computer, printer, software

TOTAL \$ 126,545

GRAND TOTAL ALL 3 ROUNDS \$ 224,734

PART III
THE FUTURE

9. Institutionalization

Institutionalization is a goal of every technical assistance project. At the same time true institutionalization has often proven hard to achieve in practice. HSRP II set institutionalization as an important objective; and, because of the long-life of the project, it was possible to adopt a flexible plan for achieving it. Initially, emphasis was placed on working with several trade associations and institutions to develop sustainable courses in selected areas to be offered at the national level. These relations proved difficult and over time atrophied.

A turning point in the project's plans came in spring 1995 when the core senior Russia staff decided that they would create the Institute for Urban Economics (IUE) as a private, non profit policy research institute focussed on addressing the problems of Russia's cities. The Institute would carry on the work of the Housing Sector Reform Project, resources permitted. Hence, the story of institutionalization of housing reforms in Russia is significantly the story of the Institute. For this reason the next section describes the Institute more fully. The final section then outlines HSRP's overall strategy.

The Institute for Urban Economics (IUE)

The Institute was founded by six physical persons, all senior members of the HSRP staff. Registration formalities were completed in November 1995 and the Institute became fully operational in January 1996, when it received its first contract from the Urban Institute to work on HSRP.

The IUE is headed by Dr. Nadezhda Kosareva, a senior housing policy specialist. It enjoys a prestigious Board of Trustees, including the Sergei Dubinin, former Chairman of the Central Bank of Russia, and Boris Nemstov, former First Deputy Prime Minister. The Board meets annually in February-March.

In the summer of 1998, the Institute had a staff of 60, include 43 specialists. Of the specialists, twenty had advanced degrees. The staff will likely grow somewhat by the end of 1997 as more specialists shift from the roles of the Urban Institute to the Institute. To date, the Institute's work program has been substantially the same as HSRP's, although this is changing, as described below.

The Institute's development has been impressive. Its staff took responsibility for selected aspects of HSRP in 1996 and added more tasks in 1997. The Institute is working hard at becoming well-known in the country, through the participation of its staff in seminars, creation of its home page, an aggressive publication dissemination program, and frequent contact by its staff with the media. The technical quality of its work has been impressive.

The Role of USAID and the Urban Institute. USAID has strongly supported the creation of the Institute. Language was included in the HSRP I workplan for 1995-1996 which facilitated the Urban Institute giving a contract with the Institute shortly after its creation. In summer 1997, USAID conducted a financial review of IUE's operations to determine if it could become a direct grantee: IUE passed "with flying colors."

The Urban Institute has been very active in fostering the Institute's development. In May 1995, its senior vice president worked with the founders and their accountant to design the Institute's financial

structure--one that would provide sufficient funds for essential overhead operations as well as permit the Institute to be competitive. The HSRP chief-of-party has devoted substantial time to working with Institute leadership on governance issues and in helping position the Institute to diversify its customer base. Possibly most important, all Urban Institute staff in Moscow have worked consistently to develop the skills of the Institute's middle managers. In short, the Urban Institute has mentored the Institute's management team on a day-to-day basis for the past three years.

The Urban Institute has not made any direct financial contribution to the IUE. It did, however, provide material assistance that minimized the Institute's cash requirements by advancing a substantial payment to the Institute and processing and paying the Institute's invoices immediately upon receipt.

Prospects for Sustainability. In 1996 only about 6 percent of IUE's turnover came from non Urban Institute grants and contracts. In 1997 this figure doubled to about 12 percent, while at the same time billings to Urban Institute contracts increased. Even so, it was clear that the Institute had to continue to work diligently to seek other income sources if it was going to survive when the USAID housing sector reform project closed out in September 1998.

IUE's management believes that the main elements in achieving sustainability are to diversify its client base and to expand the areas of its expertise to include those areas for which a significant demand is highly likely. As sketched below, the Institute is taking steps in both directions.

With respect to its client base, the Institute is moving to establish both additional international and domestic clients. Small contracts have resulted from contacts with the Tacis program. The World Bank has become a continuing source of support in the context of several of its projects. Contracts have been also obtained from international contractors executing projects for bilateral or multilateral clients. Deloitte-Touche awarded the Institute a contract to work on enterprise housing divestiture in Shadrinsk, and the Dutch firm, Kolpron, provided a contract for the Institute to help with implementation of the Dutch-funded housing program in Russia. A similar contract was received from Canadian Mortgage and Housing Corporation.

Gradually business is developing with Russian banks and with municipal and regional governments. With respect to banks, the Institute unquestionably has the strongest housing finance team in the country. The Certified Mortgage Lender program, cosponsored by the Union of Russian Commercial Banks, has proven financially viable. The Institute has done modest consulting with individual banks, and it has secured a significant contract from the Agency for Mortgage Lending to assist the new firm with training and with monitoring bank mortgage operations. The Institute is also a contract to help implement the Russian Government's program to provide housing to retired military officers.

Most contracts to date with municipal and regional governments have been for seminars on housing and communal service reforms. A new element, however, are modest contracts to work directly with local governments on achieving reforms. By the summer of 1998, over two dozen such contracts were received and other municipalities are expressing strong interest for work in the fall.

With respect to diversification, the Institute's management in late 1996 began a systematic program of identifying promising areas and creating programs to begin work in them using its internal resources. Often new staff with the requisite expertise must be hired. The main directions of this work are the following.

Credit ratings for sub-federal bonds. Beginning in early 1997, IUE staff, with contracted assistance from First Washington Associates, developed the capability to give credit ratings to sub-national bonds. The team did its first commercial rating in June of a Novgorod *oblast* bond issue. The

July issue of Russia's most important securities magazine, *Rinok Tsynyich Bumag*, was devoted to such ratings schemes; it carried a major story about such ratings and a story about IUE's capacity. The September issue carried the actual rating for Novgorod. The Institute has executed a Memorandum to Understanding with the magazine under which the magazine agreed to publish ratings prepared by Institute staff. Business in the balance of 1997 and 1998 was good and the Institute's reputation for this work spread. In July 1998, the Institute spun off the credit rating activity as a wholly owned for-profit entity; and in August a strategic alliance agreement was signed with Standard and Poor's under which the two firms will work together to develop a full range of rating services in Russia and some other CIS countries.

Reform of municipal communal services. The Institute is providing assistance to municipalities in regulating local communal service providers (utility companies), particularly those delivering water and wastewater and central heating. Currently, municipal officials have little idea of what is involved in real regulation--a problem exacerbated by the misleading practices endemic in the Russian accounting system. Under HSRP, practical guidelines were developed for municipalities. While general instruction on use of the guidelines through seminars will be part of the project, on-site consulting services are being provided to non HSRP client cities by Institute staff on a commercial basis.

Local economic development. Municipal officials are demonstrating a strong demand for assistance with local economic development. During the fall of 1997 the Institute acquired the necessary expertise and in 1998 it developed the corresponding flexible program of assistance for cities. The fall program includes several months of an U.S. expert working with Institute staff in Moscow. Early clients for economic development plan were Pskov and Arkanglesk.

Urban transportation policy. In February 1998 the Deputy Chairman of the Apparatus of Government asked the Institute to initiate work in this area, and to develop the capacity to be a partner of the World Bank in developing and executing future Bank projects in the sector. The Institute responded by developing the concept paper requested by the Deputy Chairman, partially with contracted assistance from the U.S. firm, Charles River Associates. It has also entered into early discussions with the World Bank on policy directions and begun direct work with the municipal bus company of Cherepovets to learn more about the issues involved and to assist the bus company to increase the efficiency of its operations.

Thanks to the initiatives in diversifying clients and subject areas, the Institute's dependence on USAID funding declined again in the year beginning October 1997. In the twelve month period from October 1996 through September 1997, IUE signed contracts of \$202,000 with non USAID clients (9 percent of the total); during the *eight* month period, October 1997 through May 1998, IUE signed similar contracts valued at \$474,000 (25 percent of the total). Overall, the Institute's sustainability prospects look very strong. This is especially the case because USAID has decided to enter into a large Cooperative Agreement with the Institute which will provide significant funding over the eighteen month period beginning September 1998.

Institutionalization Strategy

The HSRP strategy had two related elements: institutionalization of training programs and creation of the Institute for Urban Economics to continue to work on sector development and implementation of reforms in housing and communal services.

The ground work for institutionalization of training programs was carefully laid through three policies:

1. Shifting to Russian instructors for every course absolutely as soon as feasible;
2. Co-sponsoring course with trade associations and other groups to get them interest in organizing in such events and to see seminars as valuable "member services;" and,
3. In the past three years, charging realistic fees for seminars whenever the cosponsor was a commercial organization, such as a trade association, and not a government body which was not charging a fee.

Over time a cadre of interested cosponsors for hosting seminars and courses developed as a lasting resource.

At the same time it was important not to "over-supply" the market. It was clear, for example, that the demand for mortgage finance training was limited. Consequently, a single national-level organization was all that could be supported commercially. This kind of thinking was behind the strategy outlined below where the type of assistance level on which it should be provided are indicated.

Local-Level Institutionalization

Local housing reform

- training programs established to work with condominium associations on a permanent basis
- local governments knowledgeable about the procedures for "mass creation" of unit owners through privatization and condominium associations and able to continue this process

National-Level Institutionalization

Local housing reform

- training courses offered at the national level of self-sustaining basis for initiation of competitive maintenance and housing management and housing allowance administration
- creation of a core team of Moscow-based experts capable of working with municipalities on a commercial basis

Housing and construction finance

- shift in provision of consulting services from USAID-sponsorship to IUE on a commercial basis
- sustained offering of the Certified Mortgage Lender program
- periodic updating of manuals on mortgage and construction finance available to banks

Infrastructure Finance

-- development of a "resource center" at IUE to provide consulting services to interested cities

Overall, the Housing Sector Reform Project successfully completed the institutionalization effort launched under HSRP I.

10. What Remains to Be Done

Since 1992 USAID has supported technical assistance for housing and communal services reform, including certain aspects of urban land and real estate reform. The Housing Sector Reform Project has been widely viewed as highly successful in working with Russian counterparts to effect very substantial reform in a sector characterized at the beginning of transition by gross economic inefficiency and an area of high priority for improvement by the population. Subsidies to the sector have been dramatically cut, private ownership increased to cover more than half of the housing stock, prices for inputs are market-determined, units are freely bought and sold in the market, significant strides made in improving the efficiency with which housing services are provided, and systemic reform in the state rental sector undertaken, including a long term program for full cost coverage and improved maintenance and management of the still-large municipal housing stock.³⁰

The years 1996-1998 were particularly notable in the importance of HSRP in the process of developing new housing reform legislation and continuing to provide technical assistance to municipalities and banks in implementing reforms. The team worked very closely with First Deputy Prime Minister Boris Nemstov and the Ministries of Construction and Finance in launching the reinvigorated reform program sponsored by Mr. Nemstov.

Even as successful as the project has been in establishing a strong legal base and demonstrating reforms through pilot programs, its impact has necessarily been modest overall for two reasons. First the housing sector inherited from the Soviet era was highly complex and inefficient. Second, the institutional system is one in which local governments have substantial control over the pace of reform; hence, “from the top” reforms are often ineffective. Moreover, there is a continuing need to update reform legislation as experience is gained and progress made.

This section outlines four priority areas that we believe will require further attention beginning in the fall of 1998 for the transformation of the sector to be successfully completed.³¹

1. Communal services regulation and improvement. While much progress has been made in improving the efficiency of housing maintenance and management and in “getting the prices right” for housing services, much less have been accomplished in the areas of communal services reform. Tariffs for communal services rose much faster than inflation over the past several years, reflecting the deadly combination of monopolistic suppliers and weak regulatory regimes. The potential payoff appears very large: limited financial audits of the kind recently completed in St. Petersburg, typically find savings of 10-25 percent in existing tariffs.³² But technical inefficiencies also need to be documented and addressed, in part through modest but timely and well-targeted investments.

Four interrelated topics must be addressed for an intervention to be efficient and effective: (a) tariff

30 Support for these statements is in R. Struyk and N. Kosareva, “Is the Market Working.,” in R., Struyk (ed.) *Restructuring Russia's Housing Sector: 1991-1997*. (Washington, DC: Urban Institute, 1998, pp. 127-33.)

31 The priorities outlined here are consistent with the action plan outlined by the World Bank in its, *Russian Federation Housing and Utility Services: Policy Priorities for the Next Stage of Reforms*. (Washington, DC: World Bank, Report No. 17483, 1998, p.48).

32 These audits are strictly of the financial statements and confirm that expenses were incurred as reported. In some cases the auditors also check that the basis of depreciation claims, e.g., the diameter of the pipe which is being depreciated. They do not address issues of management efficiency nor of technical efficiency.

setting; (b) improved operational efficiency, in part through the introduction of competition where feasible; (c) investment finance; and (d) possible privatization of management and/or ownership of utilities. In the past eighteen months HSRP was active on tariff regulation, including the introduction of basic performance standards in management agreements, and in structuring financing for investments in water, and central heating utilities. In 1997-1998, the team worked with several pilot cities to introduce the project's newly developed guidelines for municipal regulators to use in tariff setting.

In 1998-1999 the work in these two areas should be continued by working with additional cities and developing further guideline materials incorporating the practical experience gained to date for wholesale dissemination through publications and seminars. In addition new work could be undertaken in promoting privatization of management and/or ownership, introducing management contracts, BOT and other arrangements, if possible working with some of the very large international firms specializing in this area who have expressed an interest in gaining a foothold in Russia. Improving operational technical efficiency is beyond the scope of this project but the team will recommend Russian firms with the necessary capabilities to municipalities.

2. Further development of the necessary legal base. The Russian Federation has an impressive record of passing the necessary laws and regulations to further reform in the areas of housing, housing finance, communal services, and real estate. Moreover, despite the reluctance of the State Duma to pass a progressive Land Code, important progress on land privatization has been realized. But housing reform legislation is not a one-off event. Generations of laws and implementing regulations are needed. And unfortunately, the quality of the policy and legal staffs at the relevant ministries leaves much to be desired. Hence, there is an acute need for outside Russian experts, complemented where necessary by American experts to participate in the drafting process. In 1997 HSRP was called upon, for example, to develop new Federal law defining procedures for establishing standards for the pace of sector reform applicable to Subjects of the Federation and for determining how to reduce Federal transfers to regions which were not keeping an acceptable pace. The team was also requested to design a new variant of the downpayment subsidy scheme that could be used on a mass basis for military officers being retired early because of the programmed restructuring of the armed forces. In 1998, at the request of the Government the same approach was applied to assisting miners, whose mines have been closed as part of restructuring of the coal industry, to relocate to economically more vibrant regions.

In 1998-1999 HSRP should continue to support directly the Government's initiatives. Some of these will promote the kind of communal service reforms previously discussed. Others will push the housing reform agenda -- some of these being second generation laws based on experience gained to date, such as the Condominium Law that replaced the earlier Presidential Decree. But the project should also continue to support real estate and land reform. For example, many regulations needed to implement the recently passed Law on Registration. When the Land Code is passed, the situation will be the same. It is also proposed that a limited amount of monitoring of developments in the sector be continued to inform the policy development process.

3. Commercial real estate lending. The work of the HSRP team with banks has done well to introduce advanced practices in underwriting these loans, exercising proper discipline in loan dispersal, and responding to issues arising during the loan period, including various construction-associated problems. A solid training program was developed and a half-dozen course offerings were made. The team worked directly with over 30 banks. In short, the project provided a solid foundation for such lending.

Continuation of the program for 1998-1999, but with the emphasis on working with banks in smaller cities and in regions more distant from Moscow. It is our view that one more year of work could make a very significant difference in the rate at which professional lending of this type emerges in Russia. This important not only because commercial real estate lending promotes growth generally, it is particularly important for small and medium enterprises which are often capital-starved. In addition new development work should be undertaken: working out the mechanics of syndication of large commercial real estate loans (something of great interest to the banks with whom the team is working) and working out at least at a draft level of insurance programs for title irregularities and default on such loans .

4. Promotion of housing reform in the regions. Municipalities are perhaps the key player today in determining whether housing reform will succeed fully. As the owners of the former State housing stock, they determine rent levels, the size and coverage of housing allowance payments, and maintenance and management policies for the municipal housing stock. They are also the regulators for water and district heat utilities. No matter how strong the federal legal basis, action is critically needed at the local level. Over the past five years HSRP has promoted adoption of reforms in regional cities through demonstrating the financial gains to implementing reforms (from higher rent revenues and improved maintenance and management efficiency) and making it easier to prepare the necessary normative documents and implement the actual reforms, e.g., assistance in holding the first maintenance competition. In 1997-1998 the project worked with the fourteen pilot reform cities designated by Mr. Nemstov and former Construction Minister Efim Basin plus the six cities participating in the World Bank's Enterprise Housing Divestiture Project.

A two track approach is proposed for 1998-1999. One track is a continuation of work in a modest number of cities. Because of the restrictions on USAID-supported activities working with local governments, this will be primarily with cities which contract with IUE for assistance with housing reforms. This will include the cities in the Enterprise Housing Divestiture Project who will be permitted to use World Bank loan funds for this purpose. The second track will make available valuable assistance to a much larger number of cities through a combination of an enhanced internet home page at the Institute for Urban Economics, which will contain new normative documents, reports on experience of cities in implementing reforms, and model documents; and through the distribution of written materials, including an expanded "Housing Reform Bulletin," which is now published by HSRP and sent mostly to press outlets. Next year the expanded Bulletin would be published monthly and be distributed to cities via mail and through an agreement with trade associations, such as the Union of Russian Cities.

5. Development of the Agency for Mortgage Lending. The continued development of the housing finance system is of obvious importance for Russia. The initiation of operations by the Agency for Mortgage Lending marks an extremely important development for the housing finance system. In the early phase of its operations--especially following the ruble devaluation--the Agency needs assistance in raising capital and a limited amount of additional technical assistance. USAID could be particularly helpful with in generating funds which the Agency could use for mortgage purchase by encouraging TUSRIF to make a term loan to the Agency. Preliminary discussions are underway but could be accelerated.³³

³³ The Agency and TUSRIF are also discussing the alignment of the terms on which the two organizations will purchase or refinance loans. In the first half of 1998, TUSRIF offered refinance to selected banks at clearly below market rates. This practice, if continued, will undercut the Agency's operations. It will also present a problem to TUSRIF because it is looking to the Agency to eventually purchase the loans it refinances but which are still held by the originating banks. In

With respect to technical assistance, two broad areas can be identified. One is in preparing additional banks to be originators of qualifying loans. Here the task is to work with commercial banks. The second is further assistance to the Agency directly. The most critical areas are in development of general management, for which a "shadow CEO" would be appropriate for perhaps a one-year tenure; and further assistance with the Agency's data systems, for which several months of an IT expert's assistance could be used.

other words, it looks to the Agency as its "exit strategy." But the Agency's initial policy, at least, is not to purchase loans at discount; and the banks may well not to sell them at loss which they must explicitly recognize in their accounting.